REPORT OF THE COMPTROLLER AND AUDITOR GENERAL OF INDIA

FOR THE YEAR ENDED 31 MARCH 1991

NO. 5 OF 1992

UNION GOVERNMENT
(REVENUE RECEIPTS - DIRECT TAXES)

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PREFATORY REMARKS

The Audit Report on Revenue Receipts - Direct Taxes of the Union Government (Civil) presents the results of audit of receipts under Direct Taxes comprising income-tax, wealth-tax, gift-tax, estate duty and hotel receipts tax. The Report is arranged in the following order:-

(i) Chapter 1 incorporates the statistical information regarding the working results of the tax administration and audit;

(ii) Chapter 2 includes four system appraisals on Purchase of properties by the Central Government, Scheme of Investment Allowance/Investment Deposit Account, Export incentives and Summary assessment scheme;

(iii) Chapter 3 mentions the results of audit of corporation-tax;

(iv) Chapter 4 deals, similarly, with the points that arose in the audit of income-tax;

(v) Chapter 5 covers points that arose in audit of wealth-tax, gift-tax, estate duty and hotel receipts tax.

The points brought out in this Report are those which have come to notice during the course of test audit.

OVERVIEW

Introductory

I. Under Section 16 of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971, all Government receipts, including revenues from direct taxes, fall within his audit jurisdiction. All units/wards of the Income-tax Department are generally audited on an annual basis, when a test-check of the cases finalised in the charges is undertaken. During the financial year 1990-91, 3,482 such units were audited. Audit findings of the year form part of this Audit Report.

Trend of collections vis-a-vis assessees

II. The gross receipts from Direct taxes during 1990-91 amounted to Rs. 11,028.94 crores against the estimated budget of Rs.11,152.50 crores. The proceeds from corporation tax and personal income-tax were Rs 5,335.27 crores and Rs 5,375.34 crores respectively. There was an increase in the total collection of Direct taxes during the year by Rs 1,021.16 crores (10 per cent) as compared to the year 1989-90. The number of income-tax payers borne on the books of the Department as on 31 March 1991 was 74.47 lakhs (70.27 lakhs as on 31 March 1990), of which 3.93 lakhs (5.3 percent) (3.86 lakhs as on 31 March 1990, 5.5 per cent) had income above a lakh of rupees.

An analysis of the trend of collections taking the year 1980-81 as the base year, indicated growth of Direct taxes revenues by roughly 368 per cent during the 10 year period. The increase in collections during the period under corporation tax and income-tax per se and as a percentage of the Gross Domestic Product registered almost the same growth.

A further analysis of the total collections during the year revealed that the gross pre-assessment collections by way of tax deduction at source, advance tax and self-assessment tax before adjustment of refunds accounted for Rs.11,390.87 crores out of a total gross collection of Rs.13464 crores. This was 84.60 percent of total gross collection before adjustment of refunds.

Cost of collection

III. The total expenditure incurred during the year 1990-91 in collecting the total Direct taxes was Rs.230.18 crores (2.1 percent) against Rs.210.39 crores (2.1 percent) for the earlier year 1989-90. As a percentage of the post-assessment collections of Rs.1,689.85 crores from income-tax including corporation-tax (Rs.1,356.65 crores in 1989-90), **the cost of collection was 13.6 percent (15.5 per cent in 1989-90).**

Arrears of assessments

IV Under the assessment procedure for 1990-91, all assessments were categorised into the 3 following groups according to the levels of income/loss and assigned to Deputy Commissioners, Assistant Commissioners and Income-tax Officers:

Category	Company cases	Non-company cases
A	Below Rs.50,000	Below Rs.2 lakhs
B	Between Rs.50,000 to Rs.5 lakhs	Between Rs.2 to Rs.5 lakhs
C	Above Rs.5 lakhs	Above Rs.5 lakhs

These officers were, however, required to finalise a fixed number of assessments as scrutiny cases and the rest in a summary manner subject to prescribed adjustments. The Action Plan of the Income-tax Department for the year 1990-91, envisaged the pendency of scrutiny assessments as on 31 March 1991 to be much less than as on 31 March 1990. Despite the liberalisation of the assessment procedure and summary assessment of bulk of the cases for assessment, the pendency as on 31 March 1991 stood at 12.82 lakhs against 11.87 lakhs as on 31 March 1990.

Arrears of taxes

V. The cumulative arrears of taxes as on 31 March 1991 were Rs.6,694.54 crores, of which an amount of Rs.3,691.69 crores was in respect of 2,745 cases of arrears over Rs.25 lakhs in each case. The corresponding figures as on 31 March 1990 were Rs.6,638.47 crores and Rs.4,002.26 crores (2,657 cases). According to targets fixed in the Action Plan

for clearance of arrears, a reduction of 85 percent in the arrears pertaining to current demand and 60 percent of the earlier demand, subject to an overall reduction of 10 percent of the total demand as on 1 April 1990, was contemplated.

Scope of Audit

VI. According to the Audit mandate, the Comptroller and Auditor General has to satisfy himself by adequate test check that the internal machinery is sufficiently safeguarded against any error and fraud, that the rules and procedures in the Department are designed to secure an effective check on assessment and collection of taxes and that these are being duly observed. Accordingly, the test audit embraced apart from the audit of individual assessments, comprehensive appraisals on departmental procedures and fiscal incentives.

Results of Test Audit

VII. The new procedure of assessment for 1990-91 envisaged increased voluntary compliance by tax payers and intensive scrutiny and detection of concealed income leading to deterrent punishment. These measures, it was hoped, would curb tax evasion and reduce mistakes in assessments. The results of test check, however, revealed short-levy of tax of Rs 489.13 crores in 19,387 cases, including Rs.122.48 crores in 4,441 assessments finalised in a summary manner. Out of these, 356 audit observations of very important and interesting nature involving substantial tax effect of Rs.212.15 crores have been included in this Report. In addition, the following four system appraisals wherein an aggregate short-levy of tax of Rs.193.89 crores has been noticed, also form part of the Report.

(i) Purchase of properties by Central Government.

(ii) Scheme of investment allowance/ investment deposit account.

(iii) Review of Export incentives

(iv) Mistakes in assessments completed under the summary assessment scheme

VIII.Systems Appraisal

Salient audit findings

Purchase of Properties by Central Government

5(a) Over the years several measures have been undertaken to check evasion of tax and curb proliferation of unaccounted money. In respect of transactions in real estate, where black money operations are believed to be widely prevalent, legislation was introduced in Direct Taxes statute as early as 1964 to subject the difference between the actual consideration received and the value declared in the transfer documents to capital gains and the difference between the market value and the actual consideration for transfer to gift-tax. From 1972, the law empowered the Government to acquire immovable properties costing above Rs.25,000 (Rs.1 lakh from 1 June 1984) where the consideration for the transaction was understated. However, these provisions were found ineffective. From 1 October 1986, legislation was introduced vesting the Government with powers of pre-emptive purchase of properties costing above Rs.5 lakhs as may be prescribed, situated in notified areas. Under Government notification, the financial limit has been raised to Rs.10 lakhs and the scope of the scheme has been extended to 28 cities upto April 1991. A review of the operation of the scheme was undertaken with reference to its objectives, the procedures laid down and the results achieved. The review brought out the following:

(i) Under the scheme, no immovable property with apparent consideration exceeding Rs.10 lakhs can be registered by the Registering authority without production of a No Objection Certificate obtained from the appropriate authority, based on a formal agreement entered into by the parties to the transfer at least 3 months before the intended date of transfer. The appropriate authority may, instead of issuing the No Objection Certificate, order pre-emptive purchase of the property at the stated consideration. As per the legal provisions such purchase orders are final and without encumbrances. However, the constitutional validity of the same remains **sub judice**, having been challanged on the ground that it

infringes the right to buy/sell property. Some orders of the appropriate authorities have also been challenged thr ough writs on different grounds, including procedural.

(ii)(a) Till April 1991, the operation of the scheme has remained limited to only 28 cities and to properties costing above Rs.10 lakhs. Thus even after 4 years of operation, places other than the 28 notified cities remain outside its scope. Further, as the law stands auction sales and also cases where individual shares of co-ownrs did not exceed Rs.10 lakhs remain outside the scope of the scheme. There have also been cases of tax avoidance by splitting/division of properties so as to bring the apparent consideraton below Rs.10 lakhs. Cases of lease/sub-lease of industrial undertakings as going concerns have also escaped the scope of the scheme.

(b) Cases were also noticed where owners of lands had entered into agreements with developers/promoters for exploitation of the land for construction of high rise buildings in exchange for a specified built up area therein with or without a further sum much less than the total consideration for the rights in land surrendered. These agreements do not fall within the ambit of the scheme.

(iii) According to available statistics out of over 16,000 cases received, the appropriate authorities passed orders of purchase in only 632 cases involving 632 properties out of which 301 properties were taken to courts. Till February 1991 Government sold 246 properties at a profit of R.33 crores with a margin of around 35 percent. In as many as 11,912 cases No Objection Certificates were issued. However, it is not clear as to how the appropriate authorities are undertaking screening of cases for issue of No Objection Certificates or otherwise. Though it was stated that cases were to be selected by statistical random sampling method, there has been no guidelines from the Board and there is no indication of application of any statistical sampling method.

(iv) The scheme does not provide for any built-in check to detect non-filing of statements of agreement to sell, nor has any procedure been established to deal with incomplete/deficient statements. It was seen in audit that many incomplete/deficient statements were merely rejected/filed by the appropriate authorities without any further action. There was no co-ordination between the department and other concerned Government authorities or the State Urban Land Ceiling authorities. Consequently, there have been cases of purchase of properties at a price much higher than the compensation which was payable under the relevant Urban Land Ceiling Act.

(v) There has also been no co-ordination between the different authorities within the department itself. Consequently, there has been substantial non/short levy of capital gains and/or gift tax.

(vi) The department has not undertaken any evaluation of the operation and effectiveness of the scheme. Having regard to the extent of its operation etc., it is difficult to conclude, on available indication that it has achieved the objective behind its introduction.

Scheme of investment allowance

(b) With a view to promoting modernisation and expansion of industries the income-tax law provided for a deduction by way of an investment allowance in the computation of business income at a percentage of the cost of new machinery or plant installed in the business of manufacture or production of any article or thing as specified. A review of the scheme revealed the following:

(i) The scheme aimed at generation of adequate funds internally so as to reduce dependence on external borrowings. However, undertakings remained largely dependent on borrowings, funds so generated being a very small portion of capital investment needs.

(ii) Investment allowance was linked to fixed assets installed in industrial undertaking engaged in construction, manufacture or

production of any article or thing as specified. Absence of definite meanings of the words `industrial undertaking' and `construction, manufacture or production' or even `an article or thing' in the law had led to a number of avoidable litigations. Government defined `industrial undertaking' in an identical situation on the basis of the recommendations of the PAC in their 136th Report (Eighth Lok Sabha), but did not evolve a common code of definition for uniform application;

(iii) The quantum of investment allowance is dependent on the investment in actual cost of the machinery or plant which did not include any portion of the cost met by any other person or authority. Capital cost varied with fluctuations in rates of exchange of foreign borrowings and any capital subsidy provided by Government. Though divergent opinions were expressed in courts over the treatment of the central subsidy and fluctuations in exchange rate the correct legal position has not been established by suitable amendment of law;

(iv) The test review disclosed that the existing provisions did not adequately provide for furnishing of all particulars necessary to decide on the question of admissibility of the allowance or of its correctness. These particulars could not even be called for in the cases of summary assessment in which **prima facie** admissibility of the allowance had to be decided on the returns with accompanying documents.

(v) There were a number of other observations noticed in audit about investment allowance regarding breach of conditions of eligibility, statutory requirements, excepted items, computation of cost, carry forward of unabsorbed allowance, etc., the revenue effect of which aggregated Rs 121 crores.

Review of Export incentives

(c) Realising the contribution of exports to the development of the country's economy, Government, **inter alia**, provided for tax concessions in the Income-tax law to

assessees earning foreign exchange, by way of total exemptions of the income in respect of hundred per cent export oriented undertakings and for others deductions from profits and gains relating to export or any foreign income, etc. Review of the scheme in audit revealed that:

(i) There was no assessment of the impact of the various incentives vis-a-vis the desired goals. Even complete statistical data relating to the number of assessees who had availed of the tax concessions, the extent of revenue foregone by the Government, the quantum of foreign exchange earned, etc., were not available.

(ii) There were a number of mistakes in the interpretation and application of the provisions in law involving undercharge of tax of Rs.1,648.11 lakhs.

(iii) In a number of cases the basic conditions regarding the creation of reserve/adequate reserve or retention of reserve or the production of statutory Auditor's Report were not fulfilled.

Summary assessment procedure

(d) Consistent with the policy of reposing trust on tax payers and in order to dovetail the workload to match the available manpower so as to achieve greater efficiency, the Income-tax Department has switched on to a procedure of summary assessment in the generality of the cases on the basis of income or loss returned subject to only certain prescribed adjustments.

A number of audit points with substantial revenue effect came up every year in the assessments completed under the summary assessment procedure and were reported in the successive Audit Reports. A detailed review of the scheme was included in the Audit Report for the year ended 31 March 1987 and these aspects also featured in a review of the Central Action Plan of the Income-tax Department (1988-89) included in Audit Report for the year ended 31 March 1990. According to the Action Plan 1988-89 the scheme of summary assessment was extended to all income

levels irrespective of the income or loss subject to scrutiny of only a small percentage of the cases in specified income groups. During the year 1990-91, audit observations were communicated in 4,441 cases involving revenue effect of Rs.122.48 crores. Some important points are :

(1) In Maharashtra circle, deduction in respect of profit and gains available to new industrial undertaking established after 31 March 1981 was allowed on the total income as it stood before set off of the amount of unabsorbed depreciation and investment allowance brought forward. This led to short-levy of tax of Rs 97.13 lakhs. **[Para 2.04.5(a) Sl.No.3]**

(2) In Gujarat and Karnataka circles, carry forward of business loss aggregating to Rs.195.81 lakhs allowed beyond the prescribed period of 8 years led to excess carry forward of an equal amount involving tax effect of Rs.102.80 lakhs in two cases. **[Para 2.04.5(a) Sl.No.9,19]**

(3) Non-assessment of cash compensatory support of Rs 1,091.15 lakhs in six cases as income in Maharashtra circle led to short levy of tax of Rs 678.50 lakhs including potential tax effect of Rs.440.44 lakhs. **[Para 2.04.5(a) Sl.No.23,24]**

(4) In Gujarat circle allowance of depreciation of Rs.370.97 lakhs for 21 months though there was production only for 3 months during the previous year, led to potential undercharge of tax of Rs 110.18 lakhs. **[Para 2.04.5(b) Sl.No.6]**

(5) In Karnataka circle, omission to make appropriate adjustment to the opening stock by Rs 7.71 crores as was done in valuing the closing stock of the previous year led to potential underassessment of tax of Rs 4.05 crores. **[Para 2.04.5(b) Sl.No.15]**

(6) There was incorrect allowance of double taxation relief of Rs 25.61 lakhs though the Indian Income had not suffered tax in the foreign country which led to undercharge of

tax of Rs 33.95 lakhs including interest in West Bengal circle. **[Para 2.04.5(b) Sl.No.19]**

Significant audit points

IX. Draft paragraphs.

1350 draft paragraphs relating to the computation of income and tax involving a total tax effect of Rs 343.50 crores noticed in the audit of income-tax assessments were issued to the Ministry of Finance for comments. 356 draft paragraphs involving revenue effect of Rs.212.15 crores have been included in this Report. Of these, the Ministry have so far accepted the observations in 101 cases with tax effect of Rs.24.75 crores .Internal audit of the Income-tax Department had failed to point out the mistakes in 54 cases involving tax effect of Rs.16.76 crores. Ministry's reply has not been received in 237 cases involving tax effect of Rs.183.42 crores. Significant points among them are:

CORPORATION TAX

Avoidable mistakes

(a) As in earlier years avoidable mistakes in computation of income and tax were noticed in 1153 cases involving tax effect of Rs.11.35 crores. In three cases in Maharashtra and Karnataka circles, adoption of the figures to be added while computing the taxable income as Rs 4.96 crores instead of Rs 7.49 crores in two cases and of the figures of profit of Rs 19.25 lakhs as loss in another case, led to total undercharge (including potential) of tax of Rs 2.54 crores. In another case in West Bengal circle, omission to add a sum of Rs.2.52 crores held disallowable led to undercharge of tax of Rs.1.98 crores including potential tax effect of Rs.14.70 lakhs. In two other cases in West Bengal and Maharashtra circles, arithmentical error in casting of totals for different purposes led to short-levy of tax of Rs.1.37 crores. In four more cases, in Tamil Nadu, West Bengal and Maharashtra circles, omission to correctly disallow the inadmissibles led to undercharge of tax of Rs.1.70 crores. **[Para 3.07(i) Sl.No.1,2,3 Para 3.07 (iii) Sl.No.1,2,3 Para 3.07(iv) Sl.No.1,2,3,4]**

Rates of tax

(b) In West Bengal and Maharashtra circles, in the cases of two trading companies and one investment company in which the public were not substantially interested, due to adoption of incorrect rates, tax was levied short by Rs.1.20 crores. **[Para 3.08.2(i), 3(ii), (iii)]**

Income from house property

(c) Income from house property is assessed on a notional basis and even in the case of an assessee trading in buildings, the income is legally assessable in his hands so long as the property is owned by him. In Maharashtra circle, pending sale, a building purchased by a private limited company dealing in real estate was occupied by its shareholders. Non-assessment of any income from property for 15 assessment years in respect of this property led to an aggregate short-levy of tax of Rs49.50 lakhs. **[Para 3.10]**

Income from profits and gains of business

Export markets development allowance

(d)(i) A Government company assessed in Delhi circle was allowed weighted deduction in respect of expenditure incurred for development of export markets without reducing the qualifying amount by the amount of expenditure incurred after February 1983, the remuneration paid to staff working abroad and general and site office maintenance expenses included therein. The excess deduction allowed led to underassessment of income of Rs.89.52 lakhs involving short-levy of tax of Rs 53.50 lakhs. **[Para 3.13.1]**

Agricultural development allowance

(ii) Expenditure incurred by a company in providing facilities, etc, to cultivators, growers, etc., of a product of agriculture which was used by the company in the manufacture of any article or thing is allowed as deduction, provided the expenditure was incurred prior to 1 March 1984 and was not in the form of cash assistance. Incorrect allowance of deduction in respect of such expenditure incurred on cane growers beyond the prescribed date and in the form of cash assitance by a widely held company engaged in the manufacture and

sale of sugar in Tamil Nadu circle, led to a total undercharge of tax of Rs.27.07 lakhs including potential tax effect of Rs.17.06 lakhs. **[Para 3.14]**

Rural development allowance

(iii) Payments made to an institution by an assessee for carrying out any approved programme of rural development is admissible as a deduction in computing business income. Any such payment made after 28 February 1983 qualified for the deduction if the programme involved construction of a dispensary, hospital, etc., as specified and the construction had started prior to 1 March 1983. Erroneous allowance of payment of Rs 29.73 lakhs made by a company in Maharashtra circle after the specified date, led to undercharge of tax of Rs 21.63 lakhs. **[Para 3.15]**

Contribution to superannuation fund

(iv) In accordance with executive instructions, 80 percent of the initial contribution to the superannuation fund of a company, is allowed to be deducted in five yearly instalments. In West Bengal circle, a company was allowed a total deduction of Rs 32.52 lakhs during the years 1980-81 to 1983-84. Later in appeal the company was allowed deduction for the full amount of initial contribution of Rs 50.80 lakhs paid in assessment year 1979-80. Non-withdrawal of the deduction of Rs32.52 lakhs allowed for the same amount in subsequent years' assessments resulted in an aggregate undercharge of tax of Rs24.27 lakhs. **[Para 3.16]**

Capital expenditure

(v)(1) Allowance of capital expenditure of Rs 76.97 lakhs (estimated) incurred under the scheme of development on modernisation of factories, updating agricultural techniques and for providing better housing and water supply facilities in the case of a company led to undercharge of tax of Rs 62.67 lakhs

in Assam circle over the 3 assessment years 1985-86 to 1987-88. **[Para 3.18.1]**

(2) According to the practice followed by a company assessed in West Bengal circle, valuation of ships is being done at lower of the cost or the price determined by the assessee, which was capitalised. Apparently, the difference in cost over the value so determined is written off as revenue expenditure. Allowance of such capital expenditure of Rs 112.38 debited to accounts led to potential tax effect of Rs 53.10 lakhs in the assessment year 1988-89 alone. **[Para 3.18.2]**

(3) Allowance of pre-operation expenses of Rs 23.12 lakhs in respect of a project which was not yet commissioned and expenses of Rs 37.32 lakhs debited to accounts though incurred in acquiring a new asset, in two cases of companies assessed in Kerala and West Bengal circles led to an aggregate undercharge of tax of Rs 41.65 lakhs. **[Para 3.18.3, 4]**

Bad debts

(vi)(1) Commercial banks operating outside India are allowed a deduction of the amount of profits not exceeding 40 per cent of the total income transferred to a special reserve account. Allowance of the deduction for an amount of Rs.113.79 crores on the basis of provision made in accounts without its being carried to the special reserve account, led to short-levy of tax of Rs.84.63 crores in the case of a banking company assessed in Maharashtra circle in the assessment year 1987-88. **[Para 3.21]**

Loss in fluctuation in rate of exchange

(vii) Loss arising out of fluctuation in the rate of exchange, if not backed by actual remittance, does not qualify for deduction as business expenditure. In the case of three companies assessed in Assam and West Bengal circles, allowance of such loss aggregating to Rs 1.66 crores which was not backed by actual remittance, led to undercharge of tax

including interest of Rs 1.20 crores including interest during the assessment years 1986-87 and 1987-88. **[Para 3.22.1, 2, 3]**

Unaccrued provisions, etc.

(viii) Provisions made in the accounts otherwise than for accrued or ascertained liabilities are not allowed as business expenditure. Incorrect allowance of unascertained liabilities towards provisions for taxes, liquidated damages, foreign projects and stock depreciation of coal and slow/moving and obsolescence stores, etc., in six companies' cases assessed in Delhi, Bihar, Madhya Pradesh, Assam and West Bengal circles totalling Rs 29.15 crores led to short assessment of tax of Rs 16.30 crores, including potential tax of Rs.6.72 crores. **[Para 3.25.1, 2, 3, 4, 7 & 9]**

(ix) Any sum payable by way of taxes, contribution to an approved provident fund or superannuation or gratuity or on any other fund for the welfare of the employees is not allowed as business expenditure unless actually paid in the previous year. In three cases of companies allowance of unpaid central excise duty, gratuity, etc., aggregating to Rs4.30 crores involved potential undercharge of tax of Rs 2.47 crores in Maharashtra, West Bengal and Gujarat circles. **[Para 3.25.5, 6, 11 Sl.No.2]**

(x) Omission to disallow disputed arrear claim of electricity duty of earlier years of Rs 1.76 crores which remained unpaid at the end of the previous year as in earlier year, led to underassessment of income of Rs 1.76 crores with potential revenue effect of Rs 1.02 crores in the assessment year 1985-86 in the case of a company in Rajasthan circle. **[Para 3.25.12]**

Tea business

(xi) In the case of composite business of production and trading in tea, only 40 percent of the income is deemed to be non-agricultural and liable to tax. This rule

regarding apportionment of income, it is judicially held, is not applicable to any other income by way of interest on loans advanced by the companies engaged in tea business and any interest liability on borrowings made for the business cannot be adjusted against such interest income. Non-assessment of interest income on advances to third parties as such, led to underassessment of income of Rs 44.02 lakhs involving undercharge of tax of Rs 31.64 lakhs in the assessment year 1987-88 in one company's case in West Bengal circle. **[Para 3.26.1]**

Other mistakes

(xii)(i) In Gujarat circle, three assessee companies were allowed deduction towards customs duty of Rs 3.18 crores embedded in the value of closing stock sold in the assessments for the assessment years 1984-85 to 1986-87 though no deduction was available as the customs duty had already been debited to the accounts at the time of purchase of stock. The mistake resulted in short-levy of tax of Rs.1.84 crores. **[Para 3.27.7]**

(2) Allowance of penal interest of Rs.85.10 lakhs included in the interest debit to accounts which had not arisen in the relevant year led to overstatement of loss by Rs 85.10 lakhs involving potential tax effect of Rs 44.68 lakhs in one company's case in West Bengal circle. **[Para 3.27.8]**

(3) Allowance of advance interest tax paid instead of the correct amount payable under the provisions of the Interest-tax Act while computing business income led to underassessment of income of Rs 30.78 lakhs involving short-levy of tax of Rs.23.89 lakhs in one case in Rajasthan circle. **[Para 3.27.14]**

Depreciation

(xiii)(1) In Maharashtra and Bihar circles, adoption of incorrect rates of depreciation on pollution control machinery, barges and off shore supply vessels, internal partition, dredging ships in four companies' cases led

to undercharge of tax of Rs 8.65 crores, including potential tax effect of Rs.1.25 crores. **[Para 3.28.2(i), Sl.No.1, 2, 3 & 4]**

(2) Variation in actual cost of an asset in consequence of a change in the rate of exchange of currency is permissible at the time of actual repayment of foreign currency loans and not for any intermediate fluctuations not backed by actual remittance. Allowance of depreciation of Rs 33.41 lakhs on additions to cost due to intermediate fluctuations led to total undercharge of tax of Rs 19.52 lakhs in two assessment years in West Bengal circle. **[Para 3.28.5]**

(3) In one other case in Tamil Nadu circle adoption of erroneous written down values led to allowance of excess depreciation of Rs 130.35 lakhs involving potential revenue effect of Rs 68.43 lakhs. **[Para 3.28.6]**

(4) There was incorrect allowance of depreciation on multiple shift working in respect of plant or machinery like boilers, water supply and drainage system, wireless apparatus, office appliances, weighing machine and recording instruments ,etc., in three cases in Maharashtra and Delhi circles aggregating Rs197.37 lakhs which led to short assessment of tax of Rs 117.93 lakhs including potential tax of Rs.93.50 lakhs. **[Para 3.30.3(i),(ii)& (iii)]**

Set off of unabsorbed depreciation

(5) Unabsorbed depreciation of any year is carried forward and allowed set off in later year against business income provided the business in which the loss was incurred is continued to be carried on in such later years. Excessive set off of unabsorbed depreciation already set off in earlier years under revisional orders led to underassessment of Rs 311.15 lakhs and undercharge of tax of Rs.175.85 lakhs in two cases assessed in West Bengal and Tamil Nadu circles including potentital tax effect of Rs.134.69 lakhs **[Para 3.31.1(i) & (ii)]**

Capital gains

(e) Long term capital gains from sale of roof-rights was erroneously allowed exemption from tax on a claim made by an assessee company assessed in Delhi circle, that the entire sale consideration of Rs30 lakhs was invested in specified assets within six months of the date of transfer. As per the lease deed of October 1984 the transfer was effected in June 1984 whereas the investment was made in May 1985, after expiry of the prescribed period. The irregular grant of exemption involved undercharge of tax of Rs 15 lakhs. **[Para 3.32]**

Income not assessed

(f)(i) Under an appellate order, the assessing officer excluded the cost of non-removal of over-burden from the taxable income after ascertaining the quantum of shortfall in removal of overburden. The shortfall was made good in later years to the extent of Rs.5.03 crores but the same was not assessed to tax as was held in appeal resulting in potential short-levy of tax of Rs.2.89 crores in one case in Rajasthan circle. **[Para 3.33.1(ii)]**

(ii) In a case in West Bengal circle, omission to treat a sum of Rs.57.39 lakhs on account of write back of liability as income led to potential tax effect of Rs 33.14 lakhs. **[Para 3.33.1(iii)]**

(iv) Non-assessment of central excise duty of Rs.238.80 lakhs collected by a sister concern on behalf of a company and sales tax collected of Rs.40.23 lakhs, which were not paid to Government, as trading receipts in Gujarat and West Bengal circles, respectively led to an aggregate short-levy of tax of Rs.168.92 lakhs. **[Para 3.33.2(i), 6]**

(v) In the case of four companies (West Bengal and Bihar circles) following mercantile system of accounting, non assessment of accrued interest of Rs.102.11 lakhs, claims for escalation of wages as per terms of agreement made with the Railways of 55.53 lakhs as per terms of agreement and interest on refund of tax of Rs.29.72 lakhs led to an aggregate short levy of tax of Rs 134.93 lakhs. **[Para 3.33.2(ii),(iii),3, 4]**

Set off and carry forward of losses

(g)(i) Irregular carry forward of loss of Rs.1539.76 lakhs in five companies cases (Karantaka, Uttar Pradesh and Madhya Pradesh circles) where the returns of income were filed beyond the prescribed dates and where no extensions were sought for and allowed, led to potential short-levy of Rs.816.64 lakhs. **[Para 3.34.1(i),(ii), (iii)]**

(ii) Set off of carried forward loss of Rs.7.05 crores first instead of unabsorbed depreciation as per order of priority for set off under law against income of Rs.5.28 crores led to erroneous carry forward of depreciation instead of loss leading to potential short-levy of tax of Rs 2.77 crores in one case in Karnataka circle. **[Para 3.34.2]**

Effect to appellate orders

(h)(i) In one case of West Bengal circle, deduction of Rs.1.88 crores for contingent liability was initially allowed for the assessment year 1980-81, but was withdrawn later on in rectificatory order. However, while giving effect to a subsequent appellate order on some other point, this amount was again allowed with consequent undercharge of tax of Rs.1.63 crores. **[Para 3.35.1]**

Deductions under Chapter VIA

Exemptions and reliefs

(i)(i) In the assessments of a Government company engaged in project execution and not in production of articles and of another company in respect of profits derived from power plant not held for business purposes in Maharashtra and Delhi circles, there was incorrect allowance of deduction of Rs.63.93 lakhs in respect of profits and gains from newly established industrial undertakings in backward areas involving short-levy of tax of Rs.53.62 lakhs. **[Para 3.37.1, 2]**

(ii) A closely held company in Gujarat circle, a leading soft-drink manufacturer, with vast marketing organisation, claimed various deductions aggregating to Rs 1.95 crores applicable to small scale industrial undertakings in respect of five of its units situated in different places for the assessment year 1987-88 which was allowed by the assessing officer though these branches (units) were integral parts of a single

company enterprise with the same management, control and financial arrangement and the total cost of the plant and machinery as on the last day of the previous year exceeded the limit of Rs.35 lakhs prescribed for a small sacale industrial undertaking. Irregular grant of deduction led to a total short levy of tax of Rs 1.27 crores. **[Para 3.38]**

(iii) Erroneous allowance of a total deduction of Rs.73.53 lakhs in respect of profits derived from the ships acquired after 31 March 1981 and in respect of profits from an industrial unit which had commenced commercial production after that date led to potential tax effect of Rs 43.76 lakhs in two cases in West Bengal and Rajasthan circles. **[Para 3.40.1(i),(ii)]**

(iv) Allowance of deduction in respect of income by way of royalty, etc., received from a foreign enterprise of Rs.459.90 lakhs(restricted to the gross total income) in the case of a government company assessed in Delhi circle without reducing the profits by the proportionate amount of headquarters and other common expenditure incurred led to excess deduction of Rs 83.25 lakhs involving short-levy of tax of Rs 49.75 lakhs. **[Para 3.41]**

Double taxation relief

(j) In the case of five non-resident companies, residents of Greece and Japan, (West Bengal circle) double taxtion relief of 50 percent of the Indian income-tax aggregating to Rs 2.53 crores was allowed, though the companies had incurred world losses and had not suffered any tax in the foreign countries. It led to undercharge of tax of Rs 2.68 crores, including interest. **[Para 3.42.1,2]**

Minimum tax

(k) Non-levy of minimum tax on book profits led to a total short levy of tax of Rs 5.99 crores in the case of three companies in Uttar Pradesh, Tamil Nadu and Maharashtra circles. **[Para 3.44.1(i),(ii) & 2]**

Irregular refund

(l) In Madhya Pradesh circle a State-owned corporation was allowed a refund of Rs.40.89

lakhs though at the time of refund there were two other disallowable sums of Rs.43.22 lakhs and Rs.56.20 lakhs by way of commission and provision for income-tax, the addition of which would have made the assessee company ineligible for any refund. **[Para 3.45]**

Interest

(m) Short-levy of interest of Rs.31.27 lakhs for delay in filing the return in the case of a Government company in Delhi circle, non-levy of interest of Rs.41.02 lakhs for non-payment of advance tax in the case of a widely held company in West Bengal circle, omission to levy interest for delay in payment of tax demand of Rs.93.48 lakhs in two cases in West Bengal circles and failure to deposit tax deducted at source in three cases of Rs 9.76 lakhs in Bihar circle, led to an aggregate short-levy of interest of Rs 1.76 crores. **[Para 3.46.1(i), 3.47, 3.48 Sl.No.1,2, 3.49 Sl.No.1]**

(n)(i) In West Bengal circle provision for differential excise duty of Rs 1,617.72 lakhs being ascertained liability was erroneously treated as part of the capital base.in the case of a public limited company. In another case in the same circle the whole of the general reserve instead of the general reserve as reduced by the amount of gratuity liability of Rs2,035.87 lakhs was likewise included in capital base. In yet another case in Tamil Nadu circle the amount of Rs 873.11 lakhs being liabilities towards central excise duty payable not provided for in the accounts was considered as an item of capital. These mistakes led to short-levy of surtax of Rs 201.11 lakhs. **[Para 3.57.1,2 &3]**

(ii) In the case of a non-resident shipping company (West Bengal circle) treatment of certain reserves kept as moneys for payment or discharge of unexpected claims and non-reduction of the capital with reference to the ratio of assessed income to world income led to excess computation of capital and underassessment of chargeable profits by Rs 87.61 lakhs involving short-levy of surtax of Rs 51.51 lakhs. **[Para 3.57.4]**

INCOME TAX OTHER THAN CORPORATION TAX

(o)(i) A simple error in not actually disallowing in the computation of income, a sum of Rs.1 crore out of a provision of Rs.4.62 crores as decided in the body of the assessment order, led to excess carry forward of loss of Rs 1 crore involving potential revenue effect of Rs.40 lakhs in the case of a co-operative Society in Madhya Pradesh circle. **[Para 4.06 Sl.No.1]**

(ii) The Madras High Court had held that the privilege of valuing closing stock in a consistant manner at cost or market price, whichever is lower, is available only to a continuing business and that it cannot be adopted where a business comes to an end when closing stock on hand should be valued at the market price. The Supreme Court has approved the decision. Further, conversion of a proprietory concern into a partnership or of a registered firm into a company is a transfer. In five cases of assessees, 4 registered firms and 1 proprietory concern (assessed in Uttar Pradesh, West Bengal, Madhya Pradesh and Tamil Nadu circles) omission to revalue the closing stock of business at the ruling price in the market on their discontinuance led to underassessment of income of Rs 24.75 lakhs and consequent short-levy of tax of Rs 17.91 lakhs. **[Para 4.12.1(i),(ii),(iii) &(iv)]**

(iii) In the case of a registered firm, the partner is assessable on the share income as finally assessed in the firm's assessment. Non-adoption of the correct share income after the firm's assessment in two cases in Karnataka and Delhi circles led to aggregate undercharge of tax of Rs.61.64 lakhs. **[Para 4.22 Sl.No.1,2]**

(iv). Eight individuals jointly won the first prize of Rs.1 crore of a State lottery but did not offer their individual shares for assessment (Assam circle), claiming that the entire amount had been taxed in others' hands in another circle. Non-assessment of the prize money in the hands of the association of persons in another circle, led to

underassesment of income of Rs.44.98 lakhs and non-levy of tax of Rs.30.13 lakhs. **[Para 4.23.1]**

(v) In the assessment for the assessment year 1987-88 in respect of a co-operative society (assessed in Madhya Pradesh circle), carry forward of losses of Rs 452.18 lakhs pertaining to assessment years 1979-80 to 1981-82 already set off in an earlier year's assessment and failure to give effect to the reduction in carry forward of loss of assessment year 1986-87 by Rs 9.59 lakhs resulted in excess carry forward of loss of Rs461.77 lakhs involving potential short-levy of tax of Rs 184.71 lakhs. **[Para 4.24]**

(vi) In the case of two individuals, assessed in Rajasthan and West Bengal circles there was short/non-levy of interest aggregating to Rs 50.05 lakhs. In one case, the interest rate adopted was wrong, while in the other, interest was not levied at all. **[Para 4.29.1(i) &(ii)**

OTHER DIRECT TAXES

Wealth-tax

(p)(i) In the case of a private limited company assessed in Maharashtra circle which had converted its lands worth Rs.63 into stock-in-trade at a value of Rs 1.20 crores, the revalued cost was not considered for levy of wealth-tax. This led to underassessment of wealth of Rs 2.95 crores and undercharge of wealth-tax of Rs 5.89 lakhs for three assessment years **[Para 5.11.(b)2]**.

(ii) There was non-levy of wealth-tax of Rs 9.67 lakhs in five cases of companies though they had taxable wealth as per details in assessment records **[Para 5.11.(a)(i), (ii), (iii), (iv) & (v)]**

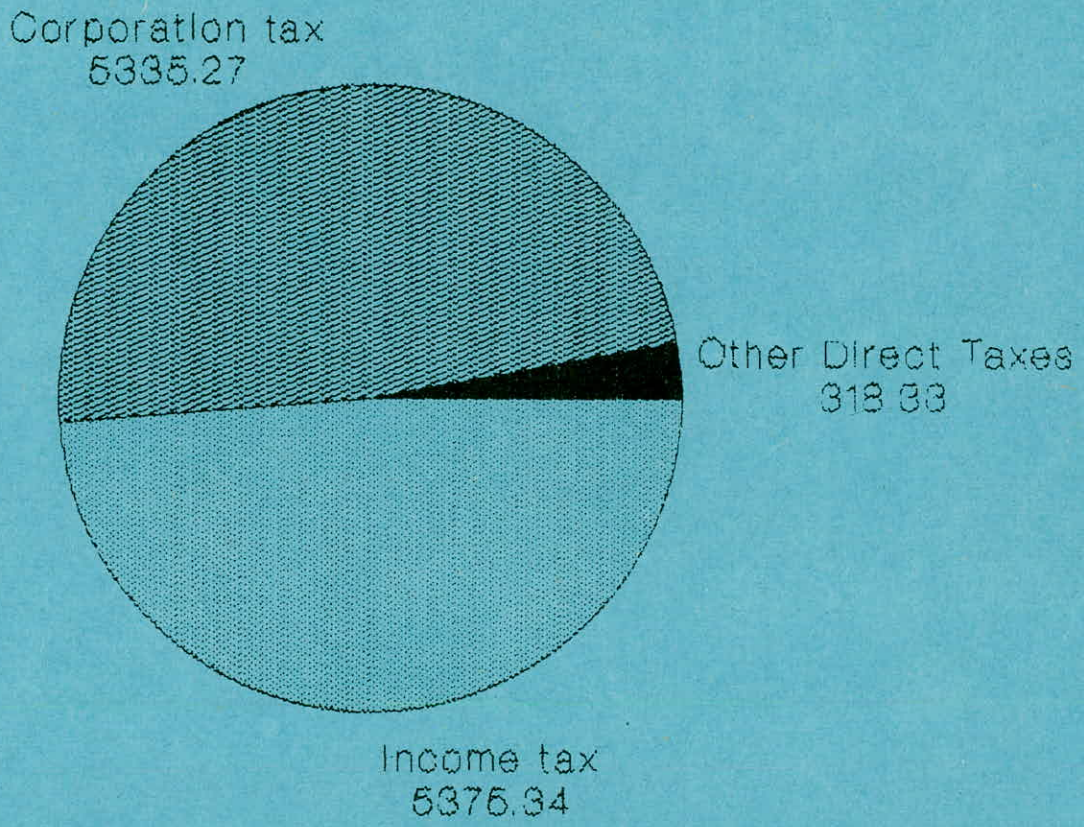
Gift-tax

(v)(i) There was non-levy of deemed gift tax of Rs.38.47 lakhs in the case of a private limited company assessed in Maharashtra circle which had sold two flats costing Rs 26.82 lakhs for Rs 9 lakhs each, though another flat costing Rs 39 lakhs in the same building was sold for Rs.1.06 crores. **[Para 5.15.1(i)]**

(ii) In another case of a private limited company assessed in West Bengal circle, a house property and certain equity shares were transferred at their book value of Rs.9.65 lakhs. On the basis of the sale value of the portion let out in the same building and the market quotations of the shares on the date of transfer of these properties there was deemed gift of Rs 76.74 lakhs. However, gift-tax of Rs 92.22 lakhs leviable on deemed gift, inclusive of penalty leviable, was not levied. **[Para 5.15.1(iv)]**

(iii) In a third case assessed in West Bengal circle, write off of a crore of rupees advanced by a private limited company to its wholly-owned subsidiary company for acquisition of a plot of land for construction of an office building as non-refundable deposit, led to non-assessment of deemed gift of Rs 1 crore arising out of the relinquishment of rights and non-levy of gift-tax of Rs.67.03 lakhs. **[Para 5.15.2(i)]**

INCOME TAX COLLECTIONS
(1990-91)



(Figures in crores of rupees)

CHAPTER 1

GENERAL

Receipts under various Direct Taxes

1.01 (i) The total proceeds from Direct Taxes for the year 1990-91* amounted to Rs.11028.94 crores out of which a sum of Rs.4119.24 crores was assigned to the States. The figures for the three years 1988-89, 1989-90 and 1990-91 are given below:-

(In crores of Rupees)

		1988-89	1989-90	1990-91*
0020	Corporation-tax	4,407.21	4728.92	5335.27
0021	Taxes on income other than Corporation-tax	4,241.24	5008.98	5375.34
0023	Hotel Receipts Tax	0.16	3.46	1.30
0024	Interest Tax	2.73	3.94	(-) 0.86
0028	Other Taxes on Income and Expenditure	42.16	71.63	80.27
0031	Estate Duty	6.04	4.27	3.07
0032	Taxes on wealth	122.48	178.51	231.17
0033	Gift tax	6.74	8.07	3.38
	Gross Total	8,828.76	10007.78	11028.94
	Less share of net proceeds assigned to the States:			
Income-tax	2,749.05	3,921.15	4119.24	
Estate Duty	0.93	----		
Hotel Receipts Tax		----	----	
	Total	2,749.98	3,921.15	4119.24
	Net Receipts	6,078.78	6,086.63	6909.70

* **Figures furnished by the Controller General of Accounts are provisional**

The gross receipts under Direct Taxes during 1990-91 went up by Rs.1021.16 crores compared with the receipts during 1989-90 against an increase of Rs.1179.02 crores in 1989-90 over those for 1988-89. Receipts under Corporation-tax and Surtax registered an increase of Rs.606.35 crores while receipts under "Taxes on Income other than Corporation-tax" accounted for an increase of Rs.366.36 crores.

(ii) The trend in collection of Direct Taxes during the last ten years ending 31 March 1990 vis-a-vis the collection for the year 1980-81 is as under:

Year	Collection (in crores of rupees)				Index taking 1980-81 as base			
	Corporation tax	Income-tax other than Corporation Tax	Other Direct Taxes	Total	Corporation tax	Income-tax other than Corporation tax	Other Direct Taxes	Total
1980-81	1377.45	1439.93	179.75	2997.13	100	100	100	100
1981-82	1969.96	1475.50	340.16	3785.62	143.0	102.5	189.2	126.3
1982-83	2184.51	1569.51	384.21	4138.23	158.6	109.0	213.7	138.1
1983-84	2492.73	1699.13	306.52	4498.38	181.0	118.0	170.5	150.1
1984-85	2555.89	1927.75	313.69	4797.33	185.6	133.9	174.5	160.1
1985-86	2865.08	2511.29	245.46	5621.83	208.0	174.4	136.6	187.6
1986-87	3159.96	2878.97	197.53	6236.46	229.4	199.9	109.9	208.1
1987-88	3432.92	3192.43	131.83	6757.18	249.4	221.7	72.2	225.5
1988-89	4407.21	4241.24	180.31	8828.76	320.0	294.6	100.3	294.6
1989-90	4728.92	5008.98	269.88	10007.78	343.3	347.8	150.1	333.9
1990-91*	5335.27	5375.34	318.33	11028.94	387.3	373.3	177.1	367.9

(iii) The Corporation-tax and income-tax collections for the last ten years ending 31 March 1991

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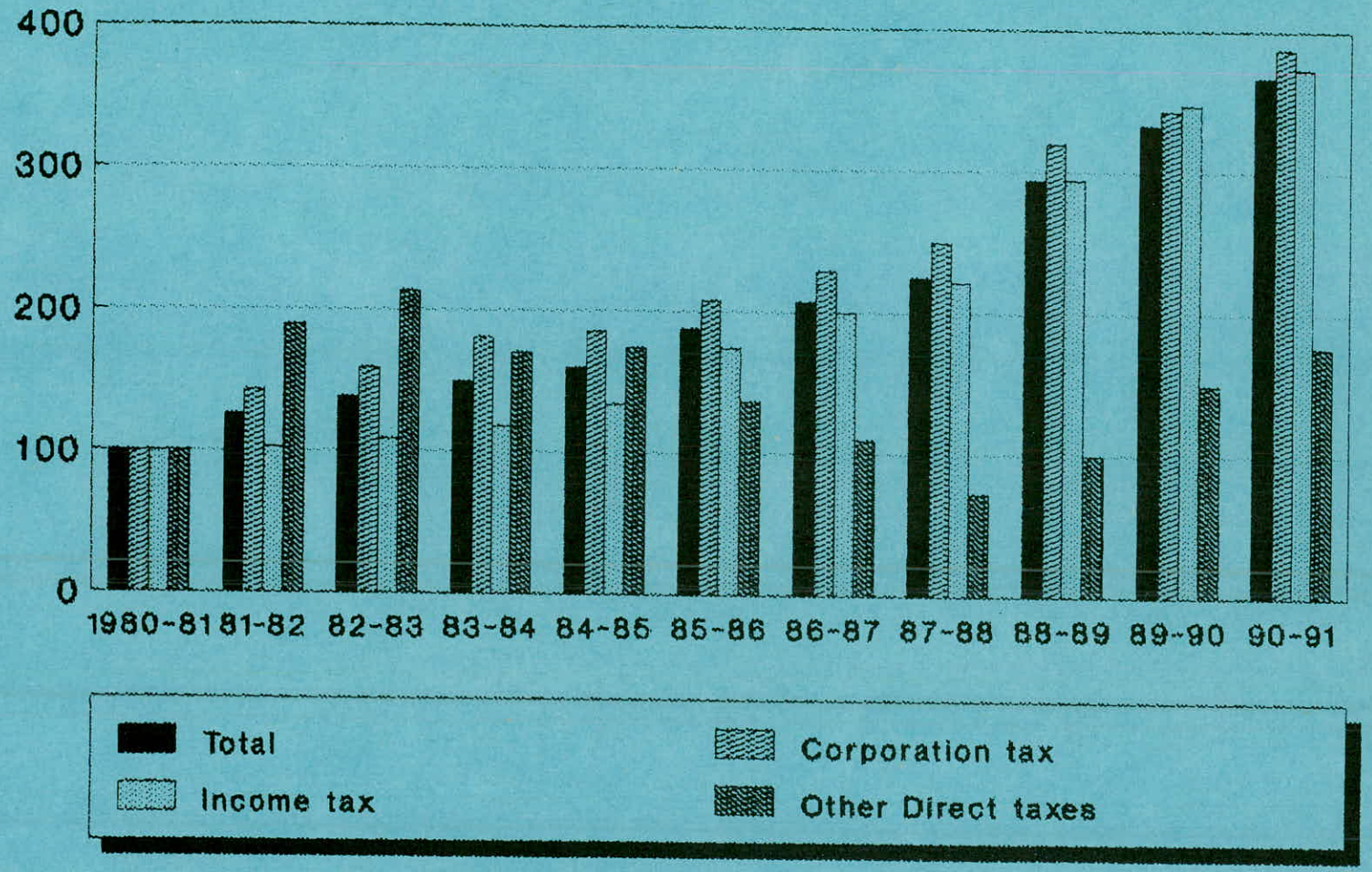
* **Figures furnished by the Controller General of Accounts are provisional**

TREND IN COLLECTION OF DIRECT TAXES OVER THE YEARS 1980-81 to 1990-91



(BASE YEAR 1980-81 - 100)

as against the figures for 1980-81, shown as a percentage of the Gross Domestic Product is as follows:

Year	Corporation tax	Income-tax other than Corporation-tax	G.D.P. at factor cost (current prices)**	Corporation tax as percent of G.D.P.	Income-tax as percent of G.D.P.
(1)	(2)	(3)	(4)	(5)	(6)
			(Rupees in crores)		
1980-81	1377.45	1439.93	1,22,427	1.1	1.2
1981-82	1969.96	1475.50	1,43,216	1.4	1.0
1982-83	2184.51	1569.51	1,59,395	1.4	1.0
1983-84	2492.73	1699.13	1,86,723	1.3	0.9
1984-85	2555.89	1927.75	2,08,577	1.2	0.9
1985-86	2865.08	2511.29	2,33,476	1.2	1.1
1986-87	3159.96	2878.97	2,59,055	1.2	1.1
1987-88	3432.92	3192.43	2,94,266	1.2	1.1
1988-89	4407.21	4241.24	3,51.724	1.3	1.2
1989-90	4728.92	5008.98	3,95,143	1.2	1.3
1990-91*	5335.27	5375.34			

Variation between Budget estimates and Actuals

4.02.1 The Actuals for the year 1990-91 under the Major head 0020-Corporation-tax and 0032-Taxes on wealth exceeded the Budget Estimates:

The figures for the years from 1986-87 to 1990-91 under the various heads are given below:

** GDP Figures collected from National Accounts Statistics Organisation, Ministry of Planning

* Figures furnished by the Controller General of Accounts are provisional

Year	Budget Estimates	Actuals	Variation	Percentage of of variation
			(In crores of Rupees)	
0020-Corporation-tax				
1986-87	3,120.00	3,159.96	39.96	1.28
1987-88	3,452.00	3,432.92	(-)19.08	(-)0.55
1988-89	4,050.00	4,407.21	357.21	8.82
1989-90	4,500.00	4,728.92	228.92	5.08
1990-91*	5,289.00	5,335.27	46.27	0.87
0021-Taxes on Income other than Corporation-tax				
1986-87	2,580.00	2,878.97	298.97	11.59
1987-88	2,845.00	3,192.43	347.43	12.21
1988-89	3,650.00	4,241.24	591.24	16.20
1989-90	4,000.00	5,008.98	1008.98	25.22
1990-91*	5,676.00	5,375.34	(-)300.66	(-)5.30
024-Interest-tax				
1986-87	----	0.72	0.72	---
1987-88	----	9.30	9.30	---
1988-89	----	2.73	2.73	---
1989-90	----	3.94	3.94	---
1990-91*	----	(-)0.86	(-)0.86	---
0031-Estate Duty				
1986-87	15.00	13.39	(-)1.61	(-)10.73
1987-88	10.00	8.02	(-)1.98	(-)19.80
1988-89	3.25	6.04	2.79	85.84
1989-90	3.10	4.27	1.17	34.74
1990-91*	3.50	3.07	(-)0.43	(-)12.28
0032-Taxes on Wealth				
1986-87	100.00	174.15	74.15	74.15
1987-88	120.00	100.58	(-)19.42	(-)16.18
1988-89	120.00	122.48	2.48	2.06
1989-90	120.00	178.51	58.51	48.75
1990-91*	175.00	231.17	56.17	32.09

*** Figures furnished by the Controller General of Accounts are provisional**

0033-Gift-tax

1986-87	15.00	9.26	(-)5.74	(-)38.27
1987-88	11.00	8.23	(-)2.77	(-)25.18
1988-89	10.00	6.74	(-)3.26	(-)32.60
1989-90	9.50	8.07	(-)1.43	(-)15.05
1990-91*	9.00	3.38	(-)5.62	(-)62.44

2*. The details of variation under the heads subordinate to the Major Heads 0020 and 0021 for the year 1990-91 are given below:

		Budget	Actuals*	Increase(+) Shortfall(-)	Percentage of variation
				(In crores of Rupees)	
0020-Corporation-tax					
(i)	Income-tax on companies	4958.00	5121.46	163.46	3.30
(ii)	Surtax	10.00	9.23	(-)0.77	(-)7.70
(iii)	Surcharge	304.00	174.10	(-)129.90	(-)42.73
(iv)	Receipts awaiting transfer to other minor heads	----	----	----	----
(v)	Other receipts	17.00	30.48	13.48	79.29
	Total	5289.00	5335.27	46.27	0.87
0021-Taxes on Income-tax other than Corporation-tax					
(i)	Income-tax	5322.00	5245.66	(-)76.34	(-)1.41
(ii)	Surcharge	326.00	93.51	(-)232.49	(-)71.31
(iii)	Receipts awaiting transfer to	---	----	----	----

* **Figures furnished by the Controller General of Accounts are provisional**

	other minor heads				
(iv)	Other receipts	28.00	36.17	8.17	29.18
(v)	Deduct share of proceeds assignedto States	(-)4234.31	(-)4119.24	(-)115.07	(-)2.72
	Total	1441.69	1256.10	(-)185.59	(-)12.87

Analysis of collection

1.03* Under the provisions of the Income-tax Act, 1961, income-tax is chargeable for any assessment year in respect of the total income of the previous year at the rates prescribed in the annual Finance Act. The Act, however, provides for pre-assessment collection by way of deduction of tax at source, advance-tax and payment of tax on self-assessment. The post-assessment collection is of residuary taxes not so paid.

1 (i) The break-up of total collections of Corporation-tax, Surtax and Interest-tax from companies and Taxes on income other than Corporation-tax from non-companies, at pre-assessment and post-assessment stages, during the year 1990-91 as furnished by the Ministry of Finance is given below:

	Company				Non-company (Amount in crores of rupees)	
	Corporation tax	Surtax	Interest tax	Total	Income tax	Total
Tax deducted at source	1499.58	---	---	1499.58	2583.36	4082.94
Advance-tax	4085.01	---	---	4085.01	2227.64	6312.65
Self-assessment	355.98	---	---	355.98	639.30	995.28

* **Figures furnished by the Ministry of Finance are provisional**

Regular assessment	1118.25	9.42	---	1127.67	562.18	1689.85
Other receipts including surcharge	207.17	---	---	207.17	175.89	383.06
Total collections	7265.99	9.42	---	7275.41	6188.37	13463.78
Refunds	(-)1944.60	0.19	---	1944.79	827.74	2772.53
Net collections	5321.39	9.23	---	5330.62	5360.63	10691.25

(ii) The sub-head wise break up total income-tax collections for companies, non companies and total thereof for the years 1986-87 to 1990-91, as furnished by the Ministry of Finance, is as follows:

Tax collection

(In crores of rupees)

Year	Tax Deducted at source	Advance Tax	Self Assessment	Regular Assessment	Other Receipts	Total Collections	Refunds	Net collection
Company								
1986-87	425.27	2,454.61	263.37	509.48	23.62	3,676.35	531.48	3,159.96
1987-88	830.90	2,446.24	195.06	633.81	31.13	4,137.14	704.23	3,432.91
1988-89	841.12	3,347.50	337.10	501.92	123.67	5,151.31	744.75	4,406.56
1989-90	1,684.89	3,017.30	364.31	1,029.75	80.19	6,176.44	1,462.25	4,714.19
1990-91*	1,499.58	4,085.01	355.98	1,127.67	207.17	7,275.41	1,944.79	5,330.62
Non-company								
1986-87	1,070.83	1,147.00	719.86	187.81	27.46	3,152.96	335.62	2,878.05
1987-88	1,446.03	1,465.83	418.24	207.55	28.75	3,566.40	374.30	3,192.10
1988-89	1,862.79	2,085.00	454.60	195.02	45.69	4,643.10	404.94	4,238.16
1989-90	2,665.67	1,967.21	535.94	326.90	81.83	5,577.55	569.26	5,008.29
1990-91*	2,583.36	2,227.64	639.30	562.18	175.89	6,188.37	827.74	5,360.63
Total								
1986-87	1,496.10	3,601.61	983.23	697.29	51.08	6,829.31	867.10	6,038.01
1987-88	2,276.93	3,912.07	613.30	841.36	59.88	7,703.54	1,078.53	6,625.01
1988-89	2,703.91	5,432.50	791.70	696.94	169.36	9,794.41	1,149.69	8,644.72
1989-90	4,305.56	4,984.51	900.25	1,356.65	162.02	11,753.99	2,031.51	9,722.48
1990-91*	4,082.94	6,312.65	995.28	1,689.85	383.06	13,463.78	2,772.53	10,691.25

* Figures furnished by Ministry of Finance are provisional.

2* The details of tax collections from Government companies and Corporations (including nationalised banks and foreign companies) out of the company assessee in `1' above, during the year 1990-91 as furnished by the Ministry of Finance are as under:

(In crores of rupees)

	Government companies and Corporations	Foreign companies	Others	Total
Advance-tax	1680.24	146.46	1852.01	3678.71
Self-assessment	97.24	12.15	328.90	438.29
Regular assessment	442.88	97.82	812.15	1352.85
Surtax	3.19	19.81	2.53	25.53
Interest-tax	4.31	0.16	25.85	30.32
Total	2227.86	276.40	3021.44	5525.70

3.(i) The details of tax deduction at source during the year 1990-91 under broad categories are as under:-

	Amount (in crores of rupees)
Salaries	1,309.38
Interest on securities	1,009.18
Dividends	276.64
Interest	475.60
Winnings from lottery or cross word puzzles	45.33
Winnings from horse races	5.00
Payments to contractors and sub-contractors	695.40
Insurance commission	74.05
Payment to non-residents and others	192.36
Total	4,082.94

(ii)*. The details of tax deducted at source, the number of statements of tax deducted at source received and the tax actually remitted to Government account for the year 1990-91 under broad categories are as under:-

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* **Figures furnished by the Ministry of Finance are provisional**

(Rupees in crores)

Income	No. of statements received	Tax deducted as per statements	Tax remitted to Govt. Account	Balance due for remittance For the year	Balance due for remittance Upto the end of the year
(a) Salary	83,905	1058.96	1051.18	7.78	7.78
(b) Interest on Securites	1,573	95.21	95.21	-----	------
(c) Dividends	3,484	89.06	89.00	0.06	0.06
(d) Interest	65,402	218.84	218.53	0.31	0.47
(e) Lottery and Crossword Puzzles	23	26.06	26.06	-----	------
(f) Winnings from horse races	2,654	1.75	1.75	-----	-----
(g) Contractors/sub-contractors	21,476	292.06	292.05	0.01	0.01
(h) Insurance Commission	5,285	40.95	40.95	-----	-----
(i) Payment to non-resident	2,162	86.68	86.57	0.11	0.12
Total	1,85,964	1909.57	1901.30	8.27	8.46

Advance-tax

4.* Tax payable and collected by way of advance-tax during the year 1990-91 is as under:

(In crores of rupees)

	Company				Non-company	
	Corporation tax	Surtax	Interest tax	Total	Income tax	Total
1. Arrear demand	73.96	48.00	---	121.96	21.88	143.84
2. Current demand	1399.11	60.78	---	1,459.89	940.42	2400.31
3. Collections						
(a) Out of arrear demand	40.23	5.37	----	45.60	3.59	49.19

(b) Out of current demand	1350.90	16.26	----	1,367.16	937.73	2304.89
(c) Total	1391.13	21.63	----	1,412.76	941.32	2354.08
4. Balance demand						
(a) Arrear	33.73	42.63	----	76.36	18.29	94.65
(b) Current	48.21	44.52	----	92.73	2.69	95.42
(c) Total	81.94	87.15	----	169.09	20.98	190.07

Cost of collection

1.04.1 The total expenditure incurred during the year 1990-91 and earlier three years in collecting the direct taxes are as under:

Year	Collection	Expenditure	Percentage
1987-88	6,757.18	166.55	2.46
1988-89	8,828.76	187.28	2.12
1989-90	10,004.78	210.39	2.10
1990-91*	11,028.94	230.18	2.09

1.04.2 The expenditure incurred during the year 1990-91 in collecting Corporation-tax, Taxes on Income other than Corporation-tax and Interest-tax together with the corresponding figures for the preceding three years, is as under:

	Collection (In crores of Rupees)	Expenditure on collection	Percentage
0020-Corporation-tax			
1987-88	3,432.92	18.74	0.55
1988-89	4,407.21	20.56	0.47
1989-90	4,728.92	25.24	0.53
1990-91*	5335.27	27.62	0.52
0021-Taxes on income etc.			
1987-88	3,192.43	131.15	4.11
1988-89	4,241.24	148.42	3.50
1989-90	5,008.98	164.10	3.28
1990-91*	5,375.34	179.53	3.33
0024-Interest-tax			
1987-88	9.30	0.02	0.22

* **Figures furnished by the Ministry of Finance are provisional**

1988-89	2.73	0.02	0.73
1989-90	3.94	0.02	0.50
1990-91*	(-)0.86	0.02	0.02

0028- Other taxes on income and expenditure

1987-88	5.70		
1988-89	42.16	1.28	3.03
1989-90	71.63	1.47	2.05
1990-91*	80.27	1.61	2.00

3. The expenditure incurred during the year 1990-91 in collecting other direct taxes **i.e.** Taxes on wealth, gift-tax and Estate duty together with the corresponding figures for the preceding three years, is as under:

	Collection (In crores of Rupees)	Expenditure on collection	Percentage
0031-Estate Duty			
1987-88	8.02	3.31	41.27
1988-89	6.04	0.55	9.10
1989-90	4.27	0.63	14.75
1990-91*	3.07	0.69	22.47
0032-Taxes on wealth			
1987-88	100.58	11.66	11.59
1988-89	122.48	14.62	11.93
1989-90	178.51	16.83	9.42
1990-91*	231.17	18.41	7.96
0033-Gift-tax			
1987-88	8.23	1.67	20.29
1988-89	6.74	1.83	27.15
1989-90	8.07	2.10	26.02
1990-91*	3.38	2.30	68.04

Number of assessees

Income-tax

1.05.1 Under the provisions of the Income-tax Act, 1961, tax is chargeable on the total income of the previous year of every person. The term `Person' includes an individual, a Hindu undivided family, a company, a firm, an association of

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*** Figures furnished by the Ministry of Finance are provisional**

persons, or a body of individuals, a local authority and an artificial juridical person.

For the assessment year 1990-91 no income-tax was payable on a total income not exceeding Rs.22,000 except in the case of specified Hindu undivided family, registered firms, co-operative society, local authority and company where a lower limit is applicable.

(i) The total number of assessees in the books of the department was 74,47,311 as on 31 March 1991* as against 70,27,154 as on 31 March 1990. The break-up of the assessees on the said two dates was as under:-

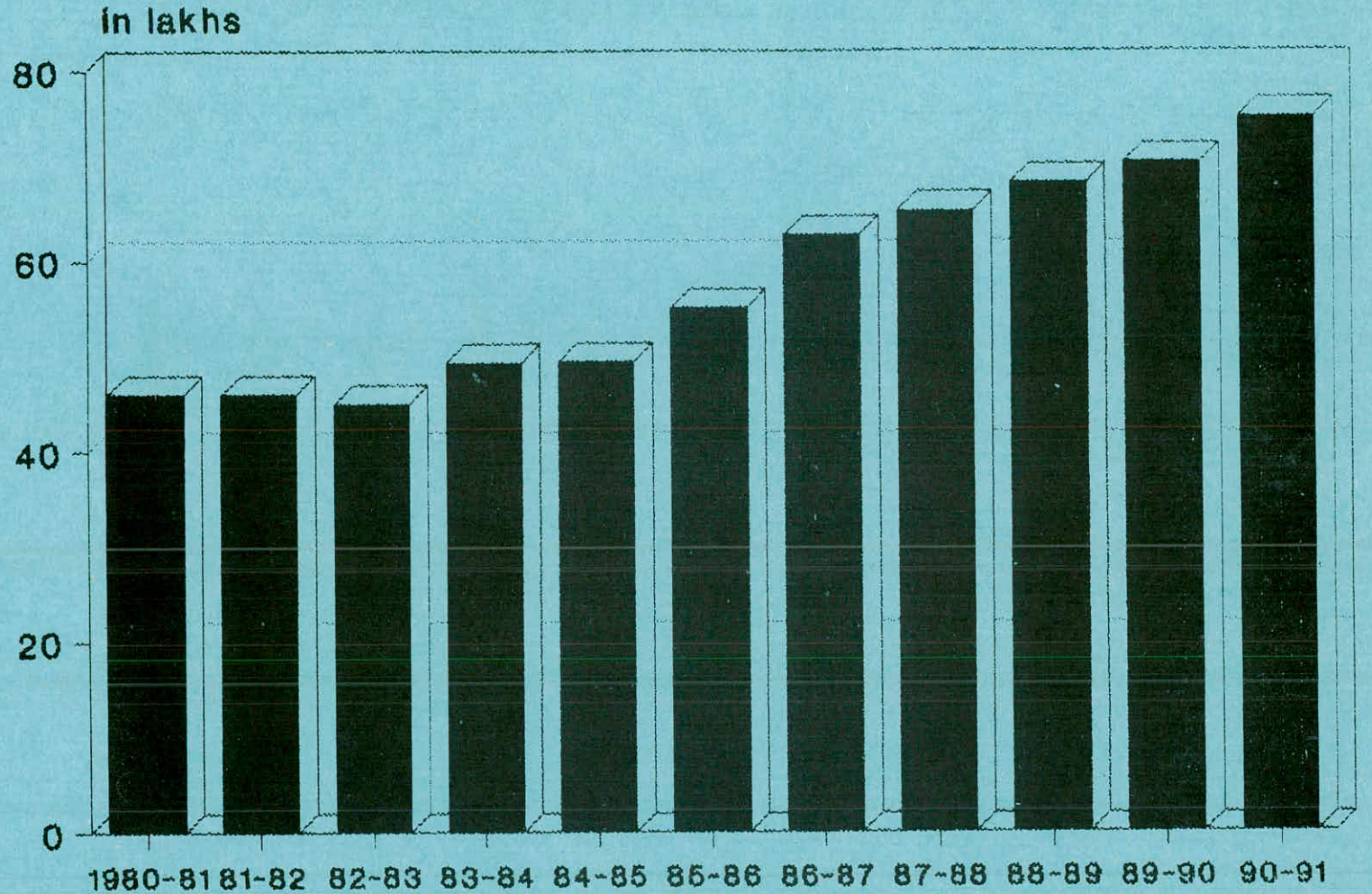
	As on 31 March 1990	As on 31 March 1991*
Individuals	52,69,084	56,92,458
Hindu undivided families	3,71,278	3,71,963
Firms	11,95,392	11,74,236
Companies	1,10,514	1,25,301
Trusts	41,451	43,092
Others	39,435	40,261
Total	70,27,154	74,47,311

(ii)* The following table indicates the break-up of assessees according to slabs of income:

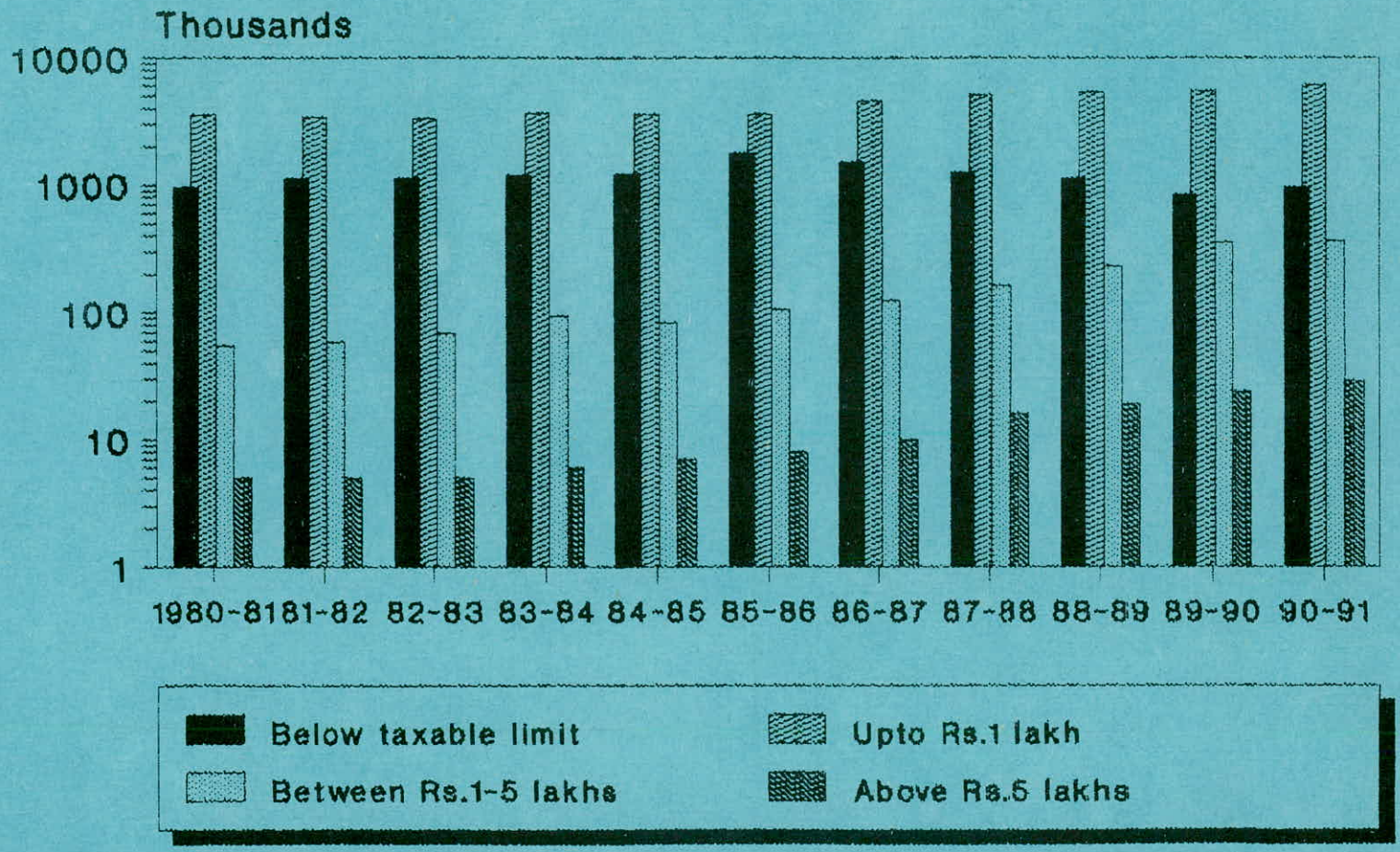
	Individuals	Hindu undivided families	Firms	Companies	Others	Total
(i) Below taxable limit	6,92,373	70,326	1,29,553	42,366	42,554	9,77,172
(ii) Above taxable limit but upto Rs.1,00,000	47,99,772	2,83,709	9,05,554	51,323	36,348	60,76,706
(iii) Rs.1,00,001 to Rs.5,00,000	,93,070	17,369	1,31,941	17,891	3,791	3,64,062
(iv) Above Rs.5,00,000	7,243	559	7,188	13,721	660	29,371
Total	56,92,458	3,71,963	11,74,236	1,25,301	83,353	74,47,311

*. **Figures furnished by the Ministry of Finance are provisional**

Total number of Assessees



NUMBER OF ASSESSEES IN LAKHS
(Slab-wise)



Surtax

2. Under the Companies (Profits) Surtax Act, 1964, surtax is levied on the `Chargeable Profits' of a company in so far as they exceed the statutory deduction, which is an amount equal to 10 percent (15 percent from 1 April 1977) of the capital of the company or Rs. two lakhs, whichever is greater.

The number of surtax assessees in the books of the department as furnished by the Ministry of Finance for the last three years was as under:

Year ending	No. of assessees
31 March 1989	2,328
31 March 1990	2,375
31 March 1991*	1,860

Interest-tax

3. The number of assessees for interest-tax in the books of the department as furnished by the Ministry of Finance for the last three years was as under:

Year ending	No. of assessees
31 March 1989	79
31 March 1990	63
31 March 1991*	52

Wealth-tax

4. Under the provisions of the Wealth-tax Act, 1957, wealth-tax is levied for every assessment year on the net wealth of every individual and Hindu undivided family according to the rates specified in the schedule to the Act. No wealth-tax is levied on companies with effect from 1 April 1960. However, levy of wealth-tax on companies has been revived in a limited way with effect from 1 April 1984.

For the assessment year 1990-91 no wealth-tax was payable where the net wealth is less than Rs.2.50 lakhs.

(i) The number of wealth-tax assessees in the books of the department as on 31 March 1990 and 31 March 1991 were as follows:-

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*. **Figures furnished by the Ministry of Finance are provisional**

	As on 31 March 1990	As on 31 March 1991*
Individuals	5,58,456	5,70,599
Hindu undivided family	74,594	75,314
Companies	12,874	14,292
Others	360	88
Total	6,46,284	6,60,293

(ii)* The following table indicates the break-up of assessees according to slabs of income:

	Individuals	Hindu undivided families	Companies	Others	Total
(i) Below taxable limit	95593	14401	2225	64	112283
(ii) Above taxable limit but upto Rs.5,00,000	347716	45690	9108	12	402526
(iii) Rs.5,00,001 to Rs.10,00,000	103854	12321	1734	7	117916
(iv) Rs.10,00,001 to Rs.15,00,000	15966	2067	654	1	18688
(v) Above Rs.15,00,000	7470	835	571	4	8880
Total	570599	75314	14292	88	660293

Gift-tax

5. Under the provisions of the Gift-tax Act, 1958 gift-tax is levied according to the rates specified in the schedule for every assessment year in respect of gifts of movable or immovable properties made by a person to another person (including Hindu undivided family or a company or an association of persons or body of individuals whether incorporated or not) during the previous year.

During the assessment year 1990-91 no gift-tax was payable where the value of taxable gifts did not exceed Rs.20,000.

*** Figures furnished by the Ministry of Finance are provisional**

The number of gift-tax assessment cases for the years 1989-90 and 1990-91 were as follows:

1989-90	71,243
1990-91*	62,572

Estate Duty

6. Under the provisions of the Estate Duty Act, 1953, in the case of every person dying after 15 October 1953 estate duty at rates fixed in accordance with Section 35 of the Act is levied upon the principal value of the estate comprised all property settled or not settled including agricultural land and which passes on the death.

No estate duty is leviable in respect of estate passing on death occuring on or after 16 March 1985.

The number of estate duty assessment cases for the years 1989-90 and 1990-91 was as follows:

1989-90	3,457
1990-91*	2,008

Arrears of assessment

1.06 The limitation period for completion of assessment is 2 years in the case of income-tax, wealth-tax and gift-tax

1. Sanctioned and working strengh of officers on assessment duty as on 31 March 1990 and 31 March 1991 were as under:

	Nature of Posts	As on 31 March 1990		As on 31 March 1991*	
		Sanctioned strength	Working strength	Sanctioned strength	Working strength
(a)	Income-tax Officers on assessment duty	2,290	1,864	2,131	1,876
(b)	Inspecting Assistant Commissioner (Asstt) [since redesignated as Deputy Commissioner (Asstt)].	223	209	266	255
(c)	Asstt. Controllers of Estate Duty	42	30	45	45

* **Figures furnished by the Ministry of Finance are provisional**

2. Income-tax including Corporation tax

(i) The number of assessments completed during the five years was as under:

Financial year	Number of assessments for disposal			Number of assessments completed			Percentage
	Scrutiny	Summary	Total	Scrutiny	Summary	Total	
1986-87	6,32,409	78,83,020	85,15,429	3,85,656	66,70,396	70,56,052	89.51
1987-88	5,29,761	70,43,560	75,73,321	3,41,570	61,23,953	64,65,523	85.37
1988-89	4,31,343	66,95,326	71,26,669	2,92,790	58,80,475	61,73,265	86.54
1989-90@	4,44,724	64,42,103	68,84,856	2,97,543	54,01,950	56,98,310	82.76
1990-91*	4,41,797	72,28,910	76,70,707	2,60,722	61,27,783	63,88,505	83.28

Number of assessments pending at the end of the year

Scrutiny	Summary	Total
2,46,753 (16.90 %)	12,12,624	14,59,377
1,88,191 (16.98 %)	9,19,607	11,07,798
1,38,553 (14.53 %)	8,14,851	9,53,404
1,47,181 (12.40 %)	10,40,153	11,86,546
1,77,766 (13.86%)	11,04,436	12,82,202

It would be seen from the above table that percentage of pending scrutiny cases has continued to remain very high, ranging from 16.90 percent in 1986-87 to 13.86 percent in 1990-91.

(ii) Status-wise break-up of income-tax assessments completed during the year 1989-90 and 1990-91 was as under:

@ **Figures are under reconciliation by Ministry of Finance**

* **Figures furnished by the Ministry of Finance are provisional**

		1989-90	1990-91*
(i)	Individuals	43,64,776	48,83,664
(ii)	Hindu undivided families	2,57,870	3,14,927
(iii)	Firms	9,29,645	10,22,070
(iv)	Companies	1,04,572	1,18,625
(v)	Association of persons	41,447	47,665
	Total	56,98,310	63,86,951@

(iii)* Status-wise and income range-wise break-up of pendency of assessments as on 31 March 1991 was as under:

Sr. No.	Status	No. of pending assessments with income			
		Upto Rs.1,00,000	Rs.1,00,001 to Rs.5,00,000	Over Rs.5,00,000	Total
1.	Companies	26,696	14,736	10,474	51,906
2.	Firms**	1,47,933	42,644	9,259	1,99,823
3.	Individuals	8,99,326	67,114	4,450	9,70,890
4.	Hindu undivided families	41,217	5,906	409	47,532
5.	Others	9,159	825	676	10,660
	Total	11,24,331	1,31,252	25,228	12,80,811@

(iv) Assessment year-wise position of pendency of income-tax assessments at the end of the last two years was as under:

	As on 31 March 1990	As on 31 March 1991
1986-87 and earlier years	8,299	5,593
1987-88	35,050	5,030
1988-89	1,67,088	42,652

@ **Figures are under reconciliation by Ministry of Finance**

1989-90	9,57,180	2,17,952
1990-91	---	10,09,584
Total	11,67,617	12,80,811@

(v)* Status-wise and year-wise break-up of pendency of income-tax assessments as on 31 March 1991 was as under:

	Status	1986-87 and earlier years	1987-88	1988-89	1989-90	1990-91	Total
(a)	Company assessments						
(i)	Regular	77	187	1,550	11,008	40,611	53,433
(ii)	Reopened/ set aside	1,133	465	376	406	1,091	3,371@
(b)	Non-company assessments						
(i)	Regular	960	2,247	36,740	2,03,522	8,89,791	11,33,260
(ii)	Reopened/ set aside	3,523	2,131	3,986	3,016	78,091	90,747
	Total	5,593	5,030	42,652	2,17,952	10,09,584	12,80,811@

The number of assessments pending as on 31 March 1991 was 12,80,811 as compared to 11,86,546 as on 31 March 1990 and 9,53,404 on 31 March 1989.

Wealth-tax, Gift-tax and Estate Duty

1.WEALTH-TAX

3.(i)* The number of wealth-tax assessments completed during the year 1990-91 was as under:

No. of assessments for disposal	No. of assessments completed	Percentage	No. of assessments pending at the end of the year
9,57,525	5,96,409@	62	3,61,116

(ii)* Status-wise break-up of the wealth-tax assessments completed during the years 1989-90 and 1990-91 were as under:

	Status	No. of assessments completed during 1989-90	1990-91*
(i)	Individuals	4,58,846	5,15,591
(ii)	Hindu undivided families	54,090	59,610
(iii)	Companies	9,742	13,681
(iv)	Others	1,219	152
	Total	5,23,897	5,89,034@

(iii)* Assessment year-wise position of pendency of assessments at the end of 1990-91 was as under:

Year	No. of assessments		Total
	Regular	Reopened	
1986-87 and earlier years	4,509	1,654	6,163
1987-88	8,941	879	9,820
1988-89	38,763	2,396	41,159
1989-90	86,532	1,086	87,618
1990-91	2,12,416	1,408	2,13,824
Total	3,51,161	7,423	3,58,584

(iv)* Status-wise and wealth range-wise break-up of pendency of wealth-tax assessments at the end of 1990-91 was as under:

Taxable Wealth-range	Number of pending assessments				
	Status				
	Individual	HUFs	Companies	Others	Total
Upto Rs.2,50,000	63,181	6,901	4,666	3,960	78,708
Rs.2,50,001 to Rs.5,00,000	1,50,088	20,795	3,618	70	1,74,571
Rs.5,00,001 to Rs.10,00,000	80,951	8,092	3,720	111	92,874

@ **Figures are under reconciliation by Ministry of Finance**

Rs.10,00,001 to Rs.15,00,000	8,032	972	457	2	9,462
Over Rs.15,00,000	4,631	486	376	7	5,501
Total	3,06,883	37,246	12,837	4,150	3,61,116

2. GIFT-TAX (i)* The number of gift-tax assessments completed during the year 1990-91 was as under:

No. of assessments for disposal	No. of assessments completed	Percentage	No. of assessments pending at the end of the year
62,572	46,621	75	15,951@

(ii)* Assessment year-wise position of pendency of assessments at the end of 1990-91 was as under:

Year	Number of assessments		Total
	Regular	Reopened	
1986-87 and earlier years	198	113	311
1987-88	395	122	517
1988-89	1,768	74	1,842
1989-90	4,644	26	4,670
1990-91	8,366	24	8,390
Total	15,371	359	15,730@

3. ESTATE DUTY (i)* The number of estate duty assessments completed during the year 1990-91 was as under:

No. of assessments for disposal	No. of assessments completed	Percentage	No. of assessments pending at the end of the year
2,008	844	42	1,164

(ii)* The number of assessments completed according to range of principal value of estate was as under:

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@ **Figures are under reconciliation by Ministry of Finance**

Principal value of estate	Number of assessments completed
Upto Rs.5,00,000	694
Rs.5,00,001 to Rs.10,00,000	80
Rs.10,00,001 to Rs.15,00,000	43
Above Rs.15,00,000	27
Total	844

(iii)* Assessment year-wise position of pendency of assessments at the end of the year 1990-91 was as under:

Assessment Year	Number of assessments		
	Regular	Reopened/ set aside	Total
1986-87 and earlier years	348	151	499
1987-88	45	19	64
1988-89	44	30	74
1989-90	31	34	65
1990-91	427	35	462
Total	895	269	1,164

(iv)* Estate value-wise pendency of assessments at the end of the year 1990-91 was as under:

Principal value of estate	Number of assessments
Upto Rs.5,00,000	586
Rs.5,00,001 to Rs.10,00,000	403
Rs.10,00,001 to Rs.15,00,000	95
Above Rs.15,00,000	80
Total	1,164

4. SURTAX (i)* The number of surtax assessments completed during the year 1990-91 was as under:

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* **Figures furnished by the Ministry of Finance are provisional**

No. of assessments for disposal	No. of assessments completed	Percentage	No. of assessments pending at the end of the year
2,890	1,039	36	1,851@

(ii)* Assessment year-wise position of pendency of assessments at the end of the year 1990-91 was as under:-

Assessment year	Number of assessments
1986-87 and earlier years	1,004
1987-88	455
1988-89	85
1989-90	111
1990-91	128
Total	1,783@

5. INTEREST TAX (i)* The number of interest-tax assessments completed during the year 1990-91 was as under:

No. of assessments for disposal	No. of assessments completed	Percentage	No. of assessments pending at the end of the year
33	23	70	10

(ii)* Assessment year-wise position of pendency of assessments at the end of the year 1990-91 was as under:

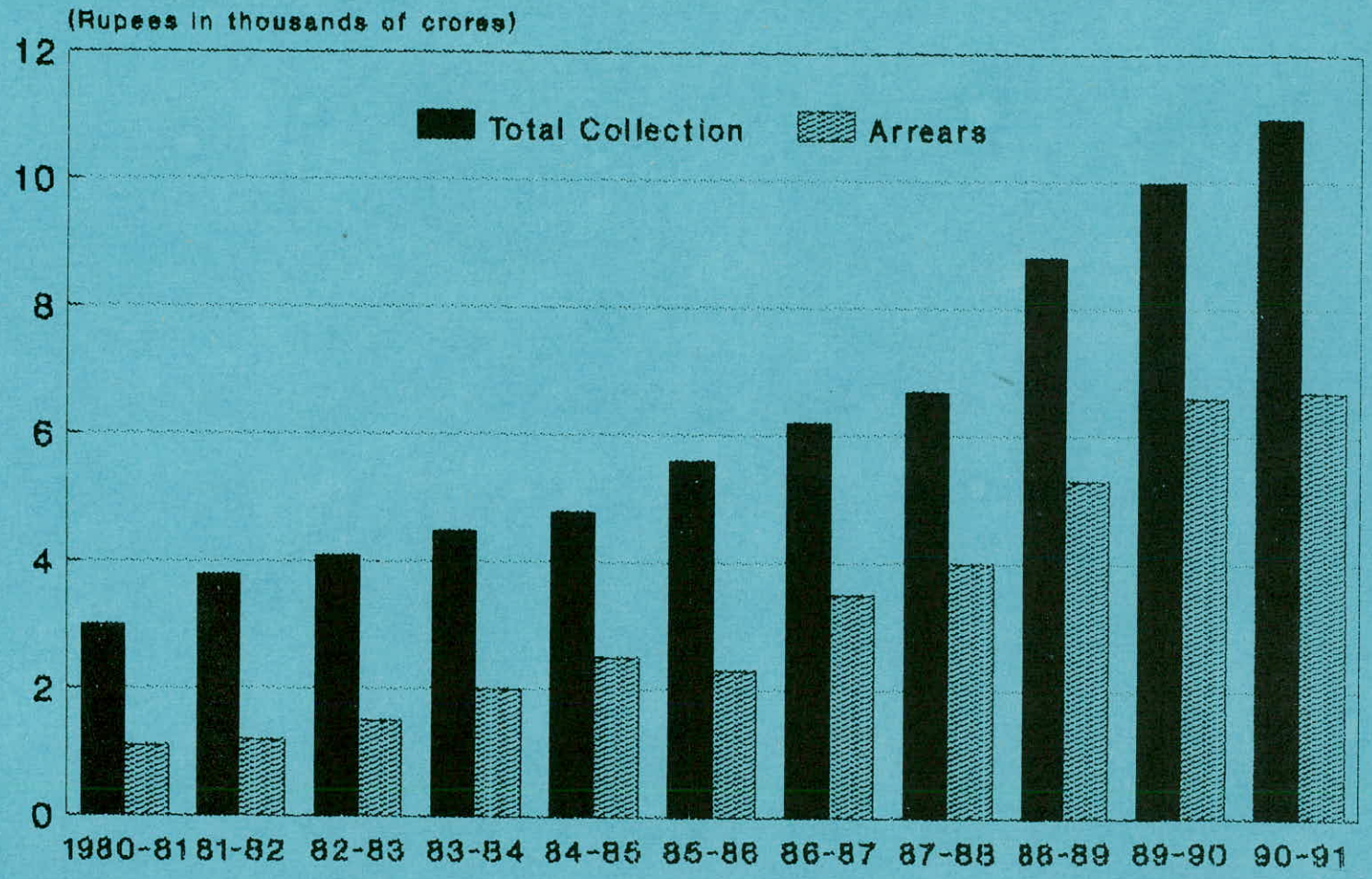
Assessment year	Number of assessments
1986-87 and earlier years	8
1987-88	1
1988-89	1
1989-90	-
1990-91	-
Total	10

@ Figures are under reconciliation by Ministry of Finance

* Figures furnished by the Ministry of Finance are provisional

ARREARS OF INCOME TAX

JUXTA POSITIONED AGAINST COLLECTION



Arrears of Tax Demands

1.07.1 The Income-tax Act, 1961, provides that when any tax, interest, penalty, fine or any other sum is payable in consequence of any order passed under the Act, a notice of demand shall be served upon the assessee. The amount specified as payable in the notice of demand has to be paid within 30 days unless the time for payment is extended by the Income-tax Officer on application made by the assessee. The Act has been amended with effect from 1 October 1975 to provide that an appeal against an assessment order would be barred unless the admitted portion of the tax has been paid before filing the appeal.

Corporation-tax (including surtax) and Income-tax

(i)(a)* The total demand of tax raised and remaining uncollected as on 31 March 1991 was Rs.6,694.54 crores, out of which arrears of Rs.3,808.71 crores related to companies. The arrears included Rs.2,175.06 crores in respect of which the permissible period of 30 days had not expired as on 31 March 1991, Rs.37.38 crores claimed to have been paid but remaining to be verified/adjusted, Rs.1,673.10 crores stayed/kept in abeyance and Rs.44.25 crores for which instalments had been granted and instalments not fallen due.

(b)* The details of demands of Income-tax (including corporation-tax) stayed/kept in abeyance as on 31 March 1991 were as under:

(In crores of rupees)

(1)	By courts	294.37
(2)	Under Section 245(F)(2) (Application to Settlement Commission)	66.44
(3)	By Tribunals	146.53
(4)	By Income-tax authorities due to	
	(i) Appeals and revisions	805.43
	(ii) Double Income Tax claims	13.61
	(iii) Restriction of remmittances Sec.220(7)	2.10
	(iv) Other reasons	344.62
	Total	1673.10

(c)* The amounts of Corporation-tax, Income-tax, interest and penalty making up the gross arrears and the year-wise details thereof are given below:

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* **Figures furnished by the Ministry of Finance are provisional**

(In crores of rupees)

	Corporation-tax	Income-tax	Interest	Penalty	Total
1986-87and earlier years	163.01	270.95	250.95	98.32	783.23
1987-88	150.01	101.34	146.56	67.86	465.77
1988-89	182.35	148.10	206.89	85.65	622.99
1989-90	572.39	307.10	496.00	105.93	1,481.42
1990-91	1522.46	707.10	879.16	232.41	3,341.13
Total	2,590.22	1,534.59	1,979.56	590.17	6,694.54

(d) The following table gives the break-up of the gross arrears of Rs.6,694.54 crores by certain slabs of income.

	Company cases			Non-company cases			Total		
	No. of cases	Gross arrears	Net arrears	No. of cases	Gross arrears	Net arrears	No. of cases	Gross arrears	Net arrears
Upto Rs.1 lakh in each cases	74851	530.50	220.88	3595692	1033.45	621.46	3670543	1563.95	842.34
Over Rs.1 lakh to Rs.5 lakhs in each case	6471	171.92	110.33	16396	329.69	213.11	22867	501.61	323.44
Over Rs.5 lakhs to Rs.10 lakhs in each case	2219	165.18	107.40	2855	199.79	125.65	5074	364.97	233.05
Over Rs.10 lakhs to Rs.25 lakhs in each case	1554	282.41	133.53	1954	289.91	156.72	3508	572.32	290.25
Over Rs.25 lakhs in each case	1550	2629.03	680.10	1195	1062.66	454.38	2745	3691.69	1134.48
Total	86645	3779.04	1252.24	3618092	2915.50	1571.32	3704737	6694.54	2823.56

(e)* Classification of tax in arrears (Gross) Amount(Rupees in crores of rupees)

		Arrears	Current	Total
1(a)	Amount due from copanies in liquidation			
	(i) Pending consideration of write-off/ scaling down petitions	1.88	0.03	1.91
	(ii) Others	8.85	16.31	25.16

* **Figures furnished by the Ministry of Finance are provisional**

	(iii) Total	10.73	16.34	27.07
(b)	Amounts due from non-company assessees involved in insolvency proceedings			
	(i) Pending consideration of scaling down petitions/write off	0.92	--	0.92
	(ii) Others	10.96	14.15	25.11
	(iii) Total	11.88	14.15	26.03
(c)	Total of (a) and (b)(iii)	22.61	30.49	53.10
2(a)	Amounts due from assessees who have left India and who have no known assets	0.11	--	0.11
(b)	Amount due from assessees who are not traceable and or who have no known assets			
	(i) Pending consideration of write off/ scaling down petitions	11.89	--	11.89
	(ii) Others	1.64	--	1.64
	(iii) Total	13.53	--	13.53
(c)	Total (a) and (b)(iii)	13.64	--	13.64

		Arrears	Current	Total
3.	Amounts due from undertakings which have been nationalised or taken over by the Government where the erstwhile owners do not have enough assets to pay the tax			
	(i) Pending consideration of scaling down petitions/write off	--	--	--
	(ii) Others	1.26	0.50	1.76
	(iii) Total	1.26	0.50	1.76
4.	All other amounts in arrears			
	(i) Pending consideration of scaling down petitions/write off	1.89	--	1.89
	(ii) Which are not being realised for various reasons for genuine hardships	142.86	345.21	488.07

(iii)	Balance being the realisable amount	3171.15	2964.93	6136.08
(iv)	Total	3315.90	3310.14	6626.04
(v)	Total of 1(c), 2(c), 3(iii) and 4(iv)	3353.41	3341.13	6694.54

(ii)* The amounts of interest-tax in arrears and the year-wise break-up thereof are given below:-

	No. of cases	Amount (In crores of rupees)
1986-87 and earlier years	--	--
1987-88	1	0.02
1988-89	3	0.09
1989-90	8	11.06
1990-91	2	0.05
Total	14	11.22

(iii)* Other Direct Taxes (Wealth-tax, Gift-tax and Estate Duty)

The following table gives the year-wise arrears of demands outstanding and the number of cases relating thereto under the three other Direct Taxes, **i.e.,** Wealth-tax, Gift-tax and Estate duty as on 31 March 1991.

(Amounts in crores of rupees)

	Wealth-tax		Gift-tax		Estate Duty	
	Number	Amount	Number	Amount	Number	Amount
1986-87	1,44,074	138.77	26,910	8.17	12,378	15.58
1987-88	44,694	30.98	6,797	2.12	3,964	3.94
1988-89	46,377	53.57	8,335	2.93	2,365	5.91

*** Figures furnished by the Ministry of Finance are provisional**

1989-90	63,013	66.11	9,247	12.18	1,516	4.58
1990-91	1,62,692	91.03	15,606	26.84	684	3.21
Total	4,60,850	380.46	66,895	52.25	20,907	33.22

2. Under the provisions of the Income-tax Act, 1961 every demand of tax, interest, penalty or fine payable under the Act should be paid within thirty days of the service of notice of demand. On the default of an assessee in this respect, the Income-tax Officer may forward a certificate specifying the demand of arrears to the Tax Recovery Officer for recovery of demand. The Tax Recovery Officer will serve a notice on the defaulter requiring him to pay the demand within fifteen days. If the amount mentioned in the notice is not paid within the time specified therein or within such further time as the Tax Recovery Officer may grant in his discretion, the Tax Recovery Officer shall proceed to realise the amount together with interest at the rate of 1.5 percent per month or part of month from 1 April 1989 on the outstandings till the date of recovery by one or more of the following modes.

(a) by attachment and sale of the defaulter's movable property;

(b) by attachment and sale of the defaulter's immovable property;

(c) by arrest of the defaulter and his detention in prison;

(d) by appointing a receiver for the management of defaulter's movable and immovable properties.

(i)* The number of officers engaged in tax recovery work during 1990-91 was as follows:

Particulars	Sanctioned strength	Working strength
Commissioners (Recovery)	3	3
Tax Recovery Officers	212	178

(ii)* The tax demands certified to the Tax Recovery Officers and the progress of recovery to end of 1990-91 are given in the following table:

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* **Figures furnished by the Ministry of Finance are provisional**

(In crores of rupees)

	Demand certified At the beginning of the year	During the year	Total	Demand recovered during the year	Balance at the end of year
1986-87	907.73	152.88	1060.61	295.94	764.67
1987-88	764.67	324.99	1089.66	299.91	789.75
1988-89	789.75	515.96	1305.71	315.58	990.13
1989-90@	1056.36	179.83	1236.19	328.77	907.42
1990-91	907.42	341.09	1248.51	390.82	857.69

(iii)* Year-wise break-up of certificates pending on 31 March 1991 and amount of demand:

Year of receipt of recovery certificates	No. of certificates	Amount involved (In crores of rupees)
1986-87	10,89,755	283.41
1987-88	75,752	60.36
1988-89	1,14,738	121.01
1989-90	1,22,604	247.90
1990-91	96,403	210.50
Total	14,99,252	923.18@

(iv)* Tax-wise and amount-wise analysis of pending certificates:

(In crores of rupees)

	Range of demand	Corporation-tax		Income-tax		Wealth-tax	
		No.	Amount	No.	Amount	No.	Amount
(a)	Upto Rs.10,000	34129	5.36	851810	111.60	103921	15.46
(b)	Over Rs.10,000 and below Rs.1,00,000	45891	22.61	347450	131.67	16839	14.63
(c)	Over Rs.1 lakh	2072	100.88	11020	447.83	1771	43.02
	Total	82092	128.85	1210680	691.10	122531	73.11

@ Figures are under reconciliation by Ministry of Finance

* Figures furnished by the Ministry of Finance are provisional

	Range of demand	Gift-tax		Estate duty		Interest-tax		Total	
		No.	Amount	No.	Amount	No.	Amount	No.	Amount
(a)	Upto Rs.10,000	27400	5.09	1054	0.48	1039	0.04	1019353	138.03
(b)	Over Rs.10,000 and below Rs. 1 lakh	46079	12.93	5947	1.65	52	0.13	462658	183.62
(c)	Over Rs.1 lakh	713	7.89	407	1.09	54	0.49	16037	601.20
	Total	74192	25.91	7408	3.22	1145	0.66	1498048	922.85@

(v) year-wise disposal and pendency of attached property

Year	No. of cases at the begining of the year		No. added during the year		Total	
	Movable	Immovable	Movable	Immovable	Movable	Immovable
1986-87	1882	2751	1670	590	3552	3341
1987-88	2308	3124	702	443	3010	3567
1988-89	2490	3413	811	1245	3301	4658
1989-90@	2519	4308	884	1050	3403	5358
1990-91*	2419	5099	1205	977	3624	6076

Year	No. actually disposed of		No. pending at the close of the year	
	Movable	Immovable	Movable	Immovable
1986-87	1245	217	2308	3124
1987-88	520	154	2490	3413
1988-89	863	620	2438	4038
1989-90	784	259	2419	5090
1990-91	1201	1567	2423*	4509@

3. Disposal of attached property - year-wise details of attached properties awaited disposal at the end of 1990-91 as furnished by the Ministry of Finance were as under:

Year	Number of cases				Total		Appointment of Receiver for management of properties (Amount in crores of Rupees)	
	Movable		Immovable					
	No.	Amount	No.	Amount	No.	Amount	No.	Amount
1986-87	262	9.05	581	21.51	843	30.56	--	--
1987-88	198	8.46	696	27.55	894	36.01	2	0.06

@ **Figures are under reconciliation by Ministry of Finance**

* **Figures furnished by Ministry of Finance are provisional**

1988-89	378	10.73	1006	36.04	13.84	46.77	3	0.01
1989-90	1003	36.02	1267	70.82	2280	105.84	9	0.04
1990-91	1585	16.36	1469	118.73	3054	135.11	7	0.44
Total	3426@	80.64	5019@	274.65	8455	354.29	21	0.55

Appeals, Revision Petitions and Writs

1.08.1 Under the provisions of the Income-tax Act, 1961 if an assessee is not satisfied with an assessment, a refund order etc. he can file an appeal to the Appellate Assistant Commissioner. The Act also provides for appeal by the assessee direct to the Commissioner (Appeals).

A second appeal can be taken to the Income-tax Appellate Tribunal. After the Tribunal's decision, reference on a point of law can be taken to the High Court from which an appeal lies to the Supreme Court. The assessee can also initiate writ proceedings under Article 226 of the Constitution.

A tax payer can approach the Commissioner of Income-tax to revise an order passed by an Income-tax Officer or by an Appellate Assistant Commissioner within one year from the date of such orders. The Commissioner can also take up for revision an order which, in his view, is prejudicial to the interest of revenue.

(1)* Income-tax

(a) Particulars of Income-tax appeals and revision petitions pending as on 31 March 1991 were as under:

(i) No. of income-tax appeals pending with

(a) Appellate Assistant Commissioner[Since redesignated as Deputy Commissioner (Appeals)] 1,26,577

(b) Commissioner of Income-tax (Appeals) 1,29,366

(ii) No. of income-tax revision petitions pending 15,911

Total 2,71,854

(b)(i)* Year-wise details of appeals pending with Appellate Assistant Commissioner for the five years ending 1986-87 to 1990-91 were as under:

Financial year	No. for disposal at the beginning of the year	No. added during the year	No. disposed of during the year	Pending at the end of the year
1986-87	1,50,820	1,01,317	1,18,732	1,33,405
1987-88	1,33,405	75,962	1,01,017	1,08,350
1988-89	1,07,612	75,781	79,970	1,03,423
1989-90	1,03,423	68,609	59,609	1,12,423
1990-91	1,12,423	81,029	66,875	1,26,577

(ii)* Year-wise break-up of high demand (more than 1 lakh) appeals pending with Appellate Assistant Commissioner at the end of the year 1990-91 with reference to their year of institution was as under:

Year of Institution	Number pending
1986-87	134
1987-88	161
1988-89	159
1989-90	336
1990-91	471
Total	1261

(c)(i)* Year-wise details of appeals pending with Commissioners of Income-tax (Appeals) for the five years ending 1986-87 to 1990-91 were as under:

Financial year	No. for disposal at the beginning of the year	No. added during the year	No. disposed of during the year	Pending at the end of the year
1986-87	92,484	64,924	48,338	1,09,070
1987-88	1,09,070	72,980	67,032	1,14,044
1988-89	1,14,414@	75,962	83,042	1,07,334
1989-90	1,07,334	84,876	81,822	1,10,388
1990-91	1,10,388	80,057	61,079	1,29,366

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* **Figures furnished by the Ministry of Finance are provisional**

(ii)* Year-wise break of high demand (more than 1 lakh) appeals pending with Commissioners of Income-tax (Appeals) at the end of the year 1990-91 with reference to their year of institution was as under:

Year of Institution	Number pending
1986-87 and earlier years	603
1987-88	854
1988-89	1,548
1989-90	3,943
1990-91	10,777
Total	17,725

(d)(i) Particulars of revision petitions for the five years ending 1986-87 to 1990-91 were as under:

Financial year	No. for disposal at the beginning of the year	No. added during the year	No. disposed of during the year	Pending at the end of the year
1986-87	16,840	10,177	9,483	17,534
1987-88	17,534	9,247	9,907	16,874
1988-89	17,311@	8,748	8,679	17,380
1989-90	17,380	6,740	6,532	17,588
1990-91	17,588	6,578	8,255	15,911@

(ii)* Year-wise break-up of revision petitions pending at the end of the year 1990-91 with reference to their year of institution was as under:

Year of Institution	Number pending
1986-87	1,931
1987-88	1,747
1988-89	2,109
1989-90	2,026
1990-91	2,961
Total	10,774@

@ **Figures are under reconciliation by Ministry of Finance**

* **Figures furnished by Ministry of Finance are provisional**

(2) Other Direct Taxes

(a)* Particulars of Wealth-tax, Gift-tax and Estate duty appeals and revision petitions pending as on 31 March 1991 were as under:

No. of appeals pending with		Wealth-tax	Gift-tax	Estate Duty
(i)	Appeallate Assistant Commissioner	40,429	1,773	33
(ii)	Commissioner of Income-tax (Appeals)	12,190	543	1,452
(iii)	No. of revision petitions pending	2.291	87	--
	Total	54,910	2,403	1,485

(b) Particulars of appeal cases with Appellate Assistant Commissioners and Commissioner (Appeals) and revisions petitions with Commissioners for the year 1990-91 were as under:

	Pending at the beginning of the year	Added during the year	Total	No. disposed of during the year	No. pending at the end of the year
(i)* With Appellate Assistant Commissioner					
Wealth-tax	37,782	19,554	57,336	16,907	40,429
Gift-tax	1,737	861	2,598	825	1,773
Estate duty	15	36	51	18	33
Super profits tax/Surtax	17	49	66	25	41
Interest-tax	13	--	13	6	7
Total	39,564	20,500	60,064	17,781	42,283

*** Figures furnished by Ministry of Finance are provisional**

(ii)* With Commissioner of Income-tax (Appeals)

Wealth-tax	9,734	9,080	18,814	6,624	12,190
Gift-tax	354	464	818	275	543
Estate duty	2,178	206	2,384	932	1,452
Super profits tax/Surtax	261	459	720	277	443
Interest-tax	20	64	84	38	46
Total	12,547	10,273	22,820	8,146	14,674

(iii)*Revision petitions with Commissioners

Wealth-tax	2,686	568	3,254	963	2,291
Gift-tax	140	18	158	71	87
Estate duty	-	-	--	-	-
Super profits tax Sur-tax	8	8	16	4	12
Interest-tax	1	-	1	1	-
Total	2,835	594	3,429	1,039	2,390

(c)* Year-wise break-up of pendency of high demand (more than Rs.50,000) appeals at the end of the year 1990-91 with reference to their year of institution was as under:

(i) With Appellate Assistant Commissioner

Year of institution	Wealth-tax	Gift-tax	Estate duty	Interest-tax	Super profit tax/Surtax	Total
1986-87	161	--	--	--	--	161
1987-88	57	--	--	--	--	57
1988-89	56	--	6	--	--	62
1989-90	55	1	-	19	--	75
1990-91	125	4	--	--	--	129
Total	454	5	6	19	--	484

*** Figures furnished by the Ministry of Finance are provisional**

(ii)* With Commissioners of Income-tax (Appeals)

1986-87	140	7	25	--	4	176
1987-88	79	15	8	(-)1	--	101
1988-89	225	10	27	--	--	262
1989-90	406	18	53	25	6	508
1990-91	1,037	100	42	13	57	1,249
Total	1,887	150	155	37	67	2,296[a]

(d)* Year-wise pendency of revision peition with Commissioners:

Year of filing of petition	Number pending
1986-87 and earlier years	953
1987-88	360
1988-89	310
1989-90	216
1990-91	280
Total	2,119

(e)* Writ petitions pending:

		In Supreme Court	In High Court	Total
(i)	On 31 March 1991	858	7,325	8,183
(ii)	Out of (i) above			
Pending for:				
	Over 5 years	197	2,166	2,363
	3 to 5 years	200	1,738	1,938
	1 to 3 years	287	2,006	2,293
	Upto 1 year	174	1,415	1,589
	Total	858	7,325	8,183

(f)* Cases pending with Judicial Courts

		In Supreme Court	In High Court	Total
(i)	On 31 March 1991	2,835	23,518	26,353
(ii)	Out of (i) above			
	Pending for:			
	Over 5 years	736	2,327	3,063
	3 to 5 years	469	5,567	6,027

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* **Figures furnished by Ministry of Finance are provisional**

1 to 3 years	825	9,051	7,876
Upto 1 year	814	6,573	7,387
Total	2,835	23,518	26,353

Reliefs and refunds

1.09.1* Where the amount of tax paid exceeds the amount of tax payable the assessee is entitled to a refund of the excess. If the refund is not granted by the department within three months from the end of the month in which the claim is made, simple interest at the prescribed rate becomes payable to the assessee on the amount of such refund (vide Section 237 read with Section 243 of the Income-tax Act).

(i)(a) The particulars of cases of direct refunds on which claims were made during 1986-87 to 1990-91 were as under:

Financial year	Opening Balance	Claims received during the year	Total	No. of refunds	Balance oustanding
1986-87	17,039	1,16,757	1,33,796	1,08,065	25,731
1987-88	25,731	84,064	1,10,795	98,327	12,468
1988-89	12,468	1,03,136	1,15,604	98,808	16,796
1989-90	16,796	84,611	1,01,407	76,620	24,787
1990-91	24,787	82,073	1,06,860	83,703	23,157@

(b)* Year-wise analysis of the outstanding direct refunds claims as on 31 March 1991.

Financial year in which application was made	No. of cases pending
1986-87 and earlier years	--
1987-88	--
1988-89	343
1989-90	1,126
1990-91	11,293
Total	12,762@

(ii)(a) The Act also provides for refund of any amount which may become due to an assessee as a result of any order passed in appeal or other proceedings without his having to make any claim

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@ **Figures are under reconciliation by Ministry of Finance**

on that behalf. Simple interest at the prescribed rate is payable to the assessee in such cases too.

Cases resulting in refund as a result of appellate orders and revision orders etc., during each of the five years ending 1990-91 were as under:-

Financial year	Opening Balance	Additions	Disposal	Balance
1986-87	2,176	29,072	29,291	1,957
1987-88	1,957	22,660	22,599	2,018
1988-89	2,018	20,863	21,638	1,243
1989-90	1,243	22,099	21,465	1,877
1990-91*	1,877	18,723	18,978	1,620@

(b)* Year-wise analysis of balance as on 31 March 1991 was as under:

Financial year	No. of cases pending*
1986-87	--
1987-88	--
1988-89	3
1989-90	44
1990-91	347
Total	394@

Interest

1.10 The Act provides for payment of interest by the assessee for certain default such as delayed submission of returns, delayed payment of taxes etc. In some cases, such as, those where advance-tax has been paid in excess or where a refund due to the assessee is delayed, Government have also to pay interest.

The particulars of interest paid on refunds by Government under the different provisions of the Act during the years 1988-89 1989-90 and 1990-91 are given below:

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* Figures furnished by the Ministry of Finance are provisional
@ Figures are under reconciliation by Ministry of Finance

(Amount in crores of rupees)

Section of Income-tax Act under which interest paid	1988-89		1989-90		1990-91*	
	No. of assessment	Amount	No. of assessment	Amount	No. of assessment	Amount
214	85,662	33.60	89,609	21.17	49,569	13.04
243	16	0.23	9	0.06	460	0.28
244	4,422	14.54	74,727	69.36	2,64,372	73.88

Cases settled by Settlement Commission

1.11 Under the provisions of the Income-tax Act, 1961 and the Wealth-tax Act, 1957, an assessee may at any state of a case relating to him make an application to the Settlement Commission to have the case settled. The powers and procedures of the Settlement Commission are specified in the Act. Every order of Settlement passed by the Settlement Commission is conclusive as to the matter stated therein.

The number of cases settled by the Settlement Commission during the last five years was as under:

(i) Income-tax

Financial year	No. of cases for disposal	No. of cases disposed of	Percentage	No. of cases pending
1986-87	1,835	196	10.68	1,639
1987-88	1,824	244	13.38	1,580
1988-89	1,897	243	12.81	1,654
1989-90	1,993	355	17.81	1,638
1990-91	2,000	480	24.00	1,520

(ii) Wealth-tax

Financial year	No. of cases for disposal	No. of cases disposed of	Percentage	No. of cases pending@
1986-87	650	79	12.15	571
1987-88	620	84	13.55	536
1988-89	590	97	16.44	493

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* Figures furnished by the Ministry of Finance are provisional

1989-90	537	92	17.13	445
1990-91	538	136	25.28	402

(iii)* Year-wise position of tax determined (including interest and penalty) in cases settled by Settlement Commission.

Financial year	Income-tax (In lakhs of rupees)	Wealth-tax
1986-87	3,138.41	7.08
1987-88	512.10	2.63
1988-89	1,942.16	1,773.16
1989-90	50.75	0.31
1990-91	40.31	44.52

(iv) No. of cases pending for admission before Settlement Commission 641

(v)* No. of cases held up with Settlement Commission for want of comments of the department 43

Penalties and prosecutions

1.12 Failure to furnish return of income/wealth/gift or filing a false return invites penalties under the relevant tax law. It also constitutes an offence for which the tax payer can be prosecuted. The tax law also provide for levy of penalty and prosecution for failure to produce accounts and documents, failure to deduct or pay tax, etc.

(i) Income-tax and Corporation-tax

(a) Penalty proceedings inititated, disposed of and pending for each of the three years ending 1990-91 were as under:

Year	Cases pending at the beginning of the year	Added during the year	Total	No. of cases disposed of during the year	Cases pending
1988-89	4,60,695	4,39,592	9,00,287	4,75,852	4,24,435
1989-90	4,24,435	2,71,538	6,95,973	3,14,613	3,81,360
1990-91*	3,81,360	1,98,670	5,80,030	3,08,016	2,72,014

*** Figures furnished by the Ministry of Finance are provisional**

(b) Prosecutions, launched, convicted/compounded and cases pending in the Courts for the three years ending 1990-91 were as under:

Year	Pending at the beginning of the year	Complaints filed during the year	Total	No. of cases disposed of during the year	No. of cases: Convicted	Compounded	Acquitted	Total	Total Pending
1988-89	17,437	7,515	24,952	924	115	597	212	924	24,028
1989-90	24,028	8,998	33,026	2,613	1,906	169	538	2,613	30,413@
1990-91@	30,388@	3,716	34,104	2,991	75	446	1,516	2,991	31,113

(c) Penalty and composition money levied, collected and pending for the three years 1988-89 to 1990-91 were as under:

(Amount in crores of Rs.)

Year	Opening Balance		Levied during the year		Collected during the year		Balance outstanding	
	Penalty	Composition money	Penalty	Composition money	Penalty	Composition money	Penalty	Composition money
1988-89	118.86	1.54	112.31	0.51	25.21	0.42	205.96	1.64
1989-90	205.96	1.64	85.71	2.89	45.83	1.51	245.84@	3.03
1990-91	255.04@	3.03	174.66	9.91	70.11	7.64	359.59	5.29

Other Direct Taxes

(ii)(a) Penalty proceedings initiated, disposed of and pending for each of the three years ending 1990-91 are given below:

Year	Cases pending at the beginning of the year	Added during the year	Total	No. of cases disposed of during the year	Cases pending
1988-89	94,414	49,401	1,43,815	64,073	79,742
1989-90	79,742	33,901	1,13,643	38,296	75,347@
1990-91@	76,242	39,429	1,15,663	47,156	68,507

(b) Prosecutions launched, convicted/compounded and cases pending in the Courts for the three years ending 1990-91 are given below:

@ **Figures are under reconciliation by Ministry of Finance**

Year	Pending at the beginning of the year	Complaints filed during the year	Total	No. of cases disposed of during the year	No. of cases: Convicted	Compounded	Acquitted	Total	Cases pending
1988-89	698	148	846	14	3	6	5	14	832
1989-90	832	65	897	12	4	-	8	12	885
1990-91	885	94	933@	49	3	--	46	49	884

(c) Penalty and composition money levied, collected and pending for the three years 1988-89 to 1990-91 are given below:

(Amount in crores of Rupees)

Year	Opening Balance		Levied during the year		Collected during the year		Balance outstanding	
	Penalty	Composition money	Penalty	Composition money	Penalty	Composition money	Penalty	Composition money
1988-89	12.18	0.08	4.75	0.03	3.86	0.05	13.07	0.06
1989-90	13.07	0.06	8.60	0.15	2.71	0.12	18.96	0.09
1990-91@	18.77	0.09	7.62	0.08	7.22	0.07	19.17	0.10

Searches and Seizures

1.13 Sections 132, 132-A and 132-B of the Income-tax Act, 1961 provide for search and seizure operations. A search has to be authorised by a Director of Inspection, Commissioner of Income-tax or a specified Deputy Director of Inspection or Inspecting Assistant Commissioner. Where any money, bullion, jewellery or other valuable article or thing is seized, the Income-tax Officer has after necessary investigations, to make an order with the approval of the Inspecting Assistant Commissioner within 90 days of the seizures, estimating the undisclosed income in a summary manner on the basis of the material available with him and calculating the amount of tax on the income so estimated, specifying the amount that will be required to satisfy any existing liability, and retain in his custody such assets as are, in his opinion, sufficient to satisfy the aggregate of the tax demands and

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@ **Figures are under reconciliation by Ministry of Finance**

forthwith release the remaining portion, if any, of the assets to the persons from whose custody they were seized. The books of accounts and other documents cannot be retained by the authorised officer for more than 180 days from the date of seizure unless the Commissioner approved of the retention for longer period.

(i) The number of cases in which searches and seizures were conducted for the three years ending 1988-89 to 1990-91 was as under:

Year	No. of cases where cash jewellery etc. assets were seized		No. of cases where no assets were seized
	No.	Value (in crores of Rupees)	
1988-89	3,267	120.24	2,834
1989-90	1,031	98.81	1,330
1990-91	2,010	178.41	1,382

(ii)(a) Particulars of orders under Section 132(5) passed during the three years ending 1990-91 were as under:

Year	Opening balance of cases	Search cases during the year	Total	No. of cases where orders were passed during the year	No. of cases pending at the end of the year
1988-89	1,373	3,339	4,712	2,946	1,766
1989-90	1,766	1,941	3,707	2,759	948
1990-91	924	2,218	3,142	2,204	938

(b) Particulars of income determined in the orders under Section 132(5), tax involved therein, assets retained and assets returned of the three years ending 1990-91 were as under:

Year	No. of cases where orders were passed	Income determined in the orders	Tax involved therein	Value of assets retained	Value of assets returned
		(Amount in crores of Rupees)			
1988-89	2,901	291.48	241.08	100.40	11.85
1989-90	2,682	211.57	205.44	896.09	139.92
1990-91	2,140	322.24	216.38	88.61	20.17

(iii)(a) The number of search cases out of (ii)(b) where final assessments were completed and pending for the three years ending 1990-91 was as under:

Year	Opening balance of orders U/s 132(5)	Order U/s 132(5)passed during the year	Total	No. of cases where final assessments were completed			
				Where concealed income was found	With No concealed income	Total	Balance cases
1988-89	1,992	3,923	5,915	1,801	982	2,783	3,132
1989-90	3,132	2,870	6,002	1,995	900	2,895	3,107@
1990-91	2,848@	2,296	5,144	1,668	1,027	2,695	2,449@

(b)* Year-wise particulars of pendency of orders under Section 132(5) where final assessments were pending as on 31 March 1991 were as under:

Year in which summary assessments were made	No. of cases where final assessments were pending	Out of (2) No. of cases with Settlement Commission
1988-89	2,381	59
1989-90	2,813	110
1990-91	2,161@	152

(c)* Particulars of income determined, tax levied, balance-tax outstanding after adjustment of value of assets retained on final assessment for the three years ending 1990-91 were as under:

Year	No.of cases where final assessments were completed	Income determined	Demand raised			Demand adjusted out of retained assets	Balance pending recovery (Rupees in Crores)		
			Tax	Penalty	Total		Tax	Penalty	Total
1988-89	4958	219.21	128.80	8.47	137.27	10.29	118.90	8.08	126.98
1989-90	4769	302.70	144.06	9.81	153.87	14.97	129.12	9.77	138.89
1990-91	4929	210.83	144.91	8.29	153.20	11.87	133.75	7.58	141.33

* Figures furnished by the Ministry of Finance are provisional

(d)* The number of cases of prosecutions launched, compounded and convictions obtained for the three years ending 1990-91 was as under:

Year	No.of prosecutions launched			No.of cases compounded	No.of cases in which convictions were obtained	No. of cases pending
	Opening balance	During the year	Total			
1988-89	3837	1210	5047	355	9	4692
1989-90	4692	401	5093	131	13	4962@
1990-91	17,279@	1491	1877@	2816	15	1595@

(e)* Particulars of cases returned, interest paid and cases pending for three years ending 1990-91 were as under:

Year	No.of cases where assets were due for return			No.of cases where assets returned	No.of cases where interest paid during the year	Balance cases pending
	Opening balance	Added during the year	Total			
1988-89	280	310	590	233	10	357
1989-90	357	444	801	273	4	528@
1990-91	431@	267	698	175	--	523

Survey

1.14.1 Number of cases where the powers of survey (other than those relating to ostentatious expenditure) were exercised for the three years ending 1990-91 as below.

Year	No. of premises surveyed
1988-89	8,156
1989-90	8,620
1990-91*	3,242

2. Number of cases where evidence about ostentatious expenditure was collected under Section 133A(5).

@ Figures are under reconciliation by Ministry of Finance

Year	No. of cases
1988-89	116
1989-90	221
1990-91*	544

Acquisition of Immovable Properties

1.15.1 Acquisition proceeding introduced with effect from 15 November 1972, empowers the Central Government to acquire an immovable property, where such property is transferred by sale or exchange and the true consideration for such transfer is concealed with the objective of evading tax. The scope of these provisions had been extended through the Income-tax (Amendment) Act, 1981 with effect from 1 July 1982 to cover:

(a) transfer of flats or premises owned through the medium of co-operative societies and companies;

(b) agreements of sale followed by part performance **viz.,** by actual physical possession of the property by the *de facto* buyer; and

(c) long term leases **i.e.** leases for a period of 12 years or more.

The provisions were introduced in the statute on the recommendations of the Direct Taxes Enquiry Committee, popularly known as Wanchoo Committee (1971) report on black money. The objective of the legislation is to counter evasion of tax through under-statement of the value of immovable property in sale deeds and also to check the circulation of black money, by empowering the Central Government to acquire immovable properties, including agricultural lands.

2. Acquisition proceedings under these provisions could be initiated where an immovable property of fair market value exceeding Rs.25,000 (Rs.1 lakh with effect from 1 June 1984) was transferred for any apparent monetary consideration, which was less than the fair market value by more than 15 percent of the apparent monetary consideration. The compensation payable on acquisition is the amount of the monetary consideration shown in the transfer document plus 15 percent of such amount. Regarding taking over and management of the immovable properties vested in the Government under the provisions of the

Income-tax Act, it was agreed in November 1976 in the then Ministry of Works and Housing and Ministry of Finance, that the Central Public Works Department would take over the immovable properties from the Revenue authorities after the forfeiture had become absolute, and after all formalities relating to appeal etc. provided under the law have been completed and manage the same. Accordingly the Central Board of Direct Taxes issued instructions in May 1977.

3. With effect from 1 October 1986, the provisions of Chapter XXA of the Income-tax Act, 1961 do not apply to or in relation to the transfer of any immovable property made after the 30 September 1986 (Section 269 RR).

(i) Number of Assistant commissioners of Income-tax engaged on the residual work for the year 1990-91.

	Sanctioned strength	Working strength
At the commencement of the year	23	18
At the close of the year	23	18

(ii) The number of intimations in Form 37-G received from the Registering Authorities during the three years ending 1990-91 was as under:

Year	No. of intimation received
1988-89	21,622
1989-90	13,115
1990-91*	5,537

(iii)(a) The number of notices issued, dropped, acquisition orders passed and notices pending for three years ending 1990-91 was as under:

Year	Opening balance	No. of notices issued during the year	Total	No. of notices dropped during the year	No. of cases where orders were passed	No. pending
1988-89	6,036	9,321	15,357	13,636	69	1,652
1989-90	1,652	81	1,733	756	7	970
1990-91*	970	28@	998	214	--	784

@ Figures are under reconciliation by Ministry of Finance

(b)* Year-wise particulars of pendency as on 31 March 1991 were as under:

Year of institution	No. of notices pending
1988-89 and earlier years	703
1989-90	--09
1990-91	72@
Total	784

(iv) The number of cases where acquisition orders were passed, properties acquired and the balance pending for the three years ending 1990-91 was as under:

Year	No. of cases where orders were passed			No. of cases where properties were actually taken over	Balance Number
	Opening balance	During the year	Total		
1988-89	711	46	757	57	700
1989-90	700	(-)1	701	-	698
1990-91*	698	--	698	86	612

Purchase by Central Government of immovable properties in certain cases of transfer

1.16 With a view of counter tax evasion and to curb the circulation of black money in real estate transaction, a new Chapter XXC was inserted in the Income-tax Act, 1961, with effect from 1 October, 1986 empowering the Central Government to purchase immovable properties in certain cases of transfer. To begin with, these provisions are made applicable in respect of properties proposed to be transferred for an apparent consideration exceeding Rs.10 lakhs in each case in the metropolitan cities of Bombay, Calcutta, Delhi and Madras. It has been extended to 24 more cities from 1 October 1987, 1 June 1989 and 1 April 1991.

During the financial year ended March 1991* details of properties purchased by the Central Government were as under:

	Calcutta	Madras	Ahmedabad	Total
(i) No. of statements received in Form 37-I	90	388	149	627
(ii) No. of properties purchased	2	12	15	29

* Figures furnished by Ministry of Finance are provisional

(iii) Value of properties purchased (Rs. in lakhs)	30.76	388.00	568.72	987.48
(iv) No. of value of properties where consideration exceeds Rs.50 lakhs	--	2	2	4

Details of cases pertaining to Delhi, Bombay, Lucknow and Bangalore are awaited.

Functioning of Valuation Cells

1.17.1 The Central Government established in October, 1968 a departmental Valuation Cell manned by Engineering Officers taken on deputation from the Central Public Works Department to assist the assessing officers under various direct tax laws. Certain details about the functioning of the valuation units under the Cell are given in the following sub-paragraphs:

(i) No. of valuation units/Districts:

Year	No. of valuation unit	No. of valuation districts
1986-87	78	13
1987-88	71	13
1988-89	71	13
1989-90	70	13
1990-91	70	13

(ii) No. of cases referred to valuation cells, disposed of and pending at the end of the each of three years ending 1990-91

	Year	No. for disposal at the beginning of the year@	No. of cases referred during the year	Disposed of during the year	Pending at the end of year
(a) Income-tax	1988-89	4,613	7,048	9,364	2,297
	1989-90	927	6,346	6,314	959@
	1990-91	628@	5,696	6,623	755
(b) Wealth-tax	1988-89	4,870	8,660	9,874	3,656
	1989-90	4,035@	8,887	9,875	3,047
	1990-91	3,047	7,319	8,571	1,795

@ Figures are under reconciliation by Ministry of Finance

(c) Gift-tax	1988-89	56	161	132	85[@]
	1989-90	26[@]	90	91	25
	1990-91	25	76	75	26
(d) Estate duty	1988-89	96	129	162	63
	1989-90	48[@]	45	67	26
	1990-91	26	45	67	4

Revenue demands written off by the department

1.18* A demand of Rs.601.82 lakhs in 73,391 cases was written off by the department during the year 1990-91. Details are given below category-wise:

1. Income-tax

(Amount in lakhs of Rupees)

		Company		Non-company		Total	
		No.	Amount	No.	Amount	No.	Amount
I. (a)	Assessees having died leaving behind no assets or have become insolvent or gone into liquidation	--	--	1,356	20.81	13.56	20.81
(b)	Assessees who have gone into liquidation or are defunct	--	--	1	0.17	1	0.17
	Total	--	--	1357	20.98	1357	20.98
II.	Assessees being untraceable	5	0.04	30,129	291.24	30,134	291.28
III.	Assessees having left India	--	--	217	3.96	217	3.96
IV.	other reasons:						
(a)	Assessees having no attachable assets	--	--	674	13.63	674	13.63
(b)	Amount being petty, etc.	--	--	32,484	64.39	32,484	64.39
(c)	Amount written off as a result of scaling down of demand	--	--	7,152	204.01	7,154	204.01
	Total	--	--	40,310	288.03	40,310	282.03

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* **Figures furnished by the Ministry of Finance are provisional**

V.	Amount written off on grounds of equity or as a matter of international courtesy or where time, labour and expenses involved in legal remedies for realisation are considered disproportionate to the amount of recovery.	--	--	1,373	3.57	1,373	3.57
	Grand Total	5	0.04	73,386	601.78	73,391	601.82

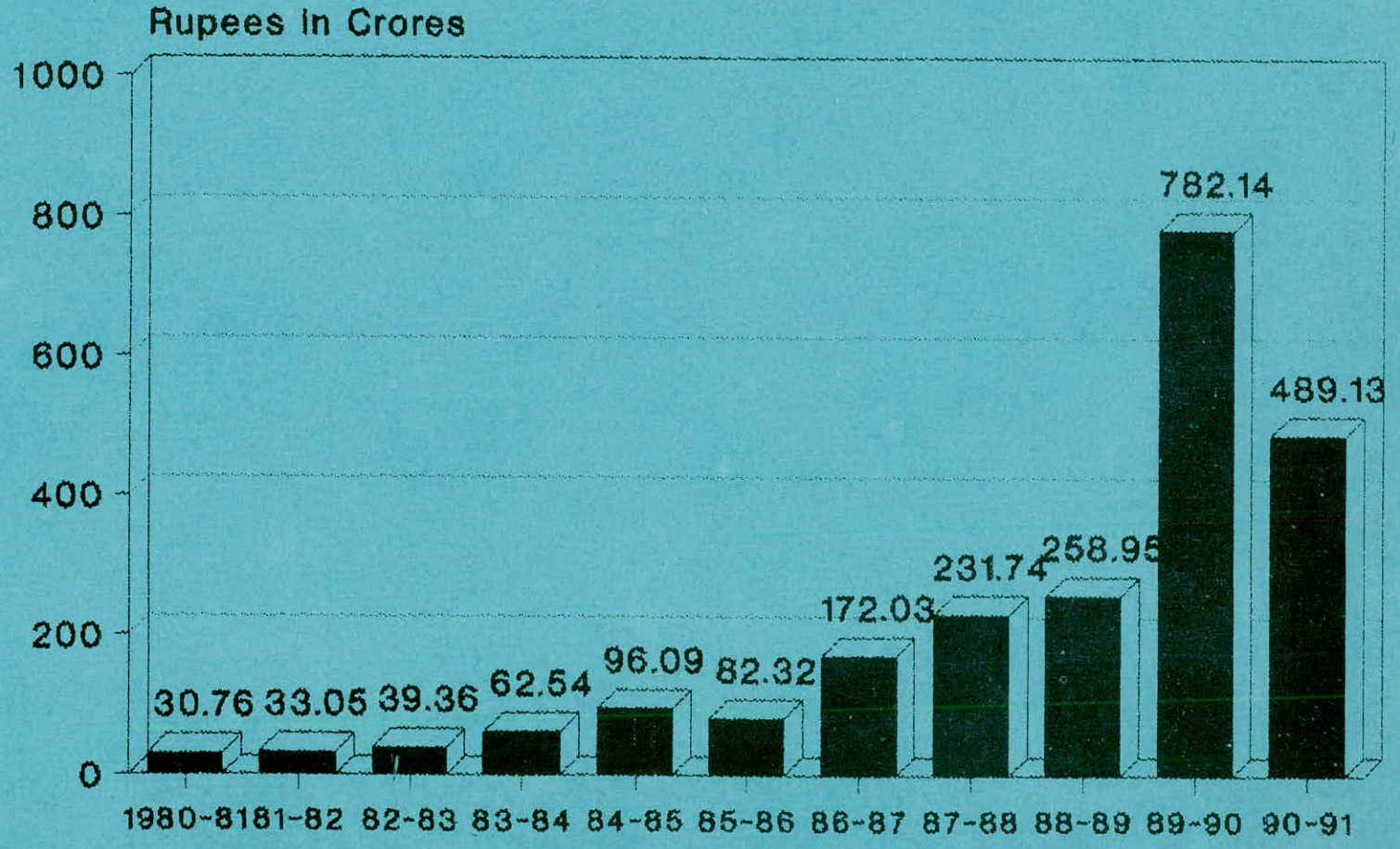
2.* Wealth-tax, Gift-tax and Estate Duty demands written off by the department during the year 1990-91 are given below category wise:

(Amount in lakhs of Rupees)

		Wealth-tax		Gift-tax		Estate Duty	
		No.	Amount	No.	Amount	No.	Amount
I.	(a) Assessees having died leaving behind no assets	--	--	--	--	--	--
	(b) Assessee having become insolvent	--	--	--	--	--	--
	Total	--	--	--	--	--	--
II.	Assessees being untraceable	44	0.08	5	0.01	--	--
III.	Assessees having left India						
IV.	Other reasons:	--	--	--	--	--	--
	(a) Assessee who are alive but have no attachable assets	--	--	--	--	--	--
	(b) Amount being petty, etc.	--	--	--	--	--	--
	(c) Amount written off as a result of settlment with assessees	--	--	--	--	--	--
	Total	--	--	--	--	--	--
V.	Amount written off on grounds of equity or as a matter of international coaurtesy or where the time, labour and expenses involved in legal remedies for realisation are considered disproportionate to the amount of recovery	--	--	--	--	--	--
	Grand Total	44	0.08	5	0.01	--	--

*** Figures furnished by the Ministry of Finance are provisional**

INCOME TAX
UNDER-ASSESSMENT



Results of Test Audit in general

1.19 During the period 1 April 1990 to 31 March 1991 in the course of test audit of the assessments completed by the Income-tax Department, 19,387 cases of under-assessment involving a total revenue effect of Rs.489.13 crores were noticed. A resume of the deficiencies noticed is given belwo:

(i) Corporation-tax and Income-tax

During the period under report, test audit brought to light total underassessment of tax of Rs.477.33 crores in 17,363 cases. Of the total 17,363 cases of underassessment, short levy of tax of Rs.449.84 crores was noticed in 7,061 major audit observations. The remaining 10,302 cases accounted for underassessment of tax of Rs.27.49 crores.

The underassessment of tax of Rs.477.33 crores arose due to mistakes which could broadly be categorised under the following heads:

		No. of cases	Amount (Rupees in crores)
1.	Avoidable mistakes in computation of income and tax	1153	11.35
2.	Failure to observe the provisions of the Finance Acts	808	34.77
3.	Incorrect status adopted in assessments	187	1.86
4.	Incorrect computation of income	399	7.74
5.	Incorrect computation of income from house property	303	1.51
6.	Incorrect computation of business income	4,616	110.94
7.	Irregularities in allowing depreciation, investment allowance and development rebate	1,610	92.68
8.	Irregular computation of capital gains	212	2.58
9.	Mistakes in assessments of firms and partners	785	5.21
10.	Omission to club the income of spouse/minor child etc.	21	0.47
11.	Income not assessed	1,795	50.92
12.	Irregular set off of losses	445	22.55
13.	Mistakes in assessments while giving effect to appellate orders	90	4.10
14.	Irregular exemptions and excess reliefs given	1,409	51.61
15.	Excess or irregular refunds	266	3.38
16.	Non-levy/incorrect levy of interest for delay in submission of returns, delay in payment of tax etc.	1,020	11.49
17.	Avoidable or incorrect payment of interest by Government	124	3.80
18.	Omission/short levy of penalty	766	8.53
19.	Other topics of interest (Miscellaneous cases)	1,229	42.46
20.	underassessment of surtax	125	9.38
	Total	17,363	477.33

It will be noticed that in terms of the number of audit objections and the amount, both the categories under serial numbers 6,7,11,14, and 19 are heavy and call for special attention from the department.

(ii) Wealth-tax

During test-audit of assessments made under Wealth-tax Act, 1957, short levy of Rs.7.65 crores was noticed in 1645 cases.

The underassessment of tax of Rs.7.65 crores was due to mistakes categorised under the following heads:

		No. of cases	Amount (in crores of rupees)
1.	Wealth not assessed	490	2.05
2.	Incorrect valuation of assets	421	2.13
3.	Mistakes in computation of net wealth	172	0.66
4.	Incorrect status adopted in assessments	44	0.04
5.	Irregular/excessive allowances and exemption	154	0.22
6.	Mistakes in calculation of tax	133	0.27
7.	Non-levy or incorrect levy of additional wealth-tax	26	1.57
8.	Non-levy or incorrect levy of penalty and non-levy of interest	140	0.34
9.	Miscellaneous	65	0.37
		1,645	7.65

(iii) Gift-tax

During the test audit of gift-tax assessments it was noticed that in 269 cases there was short levy of Rs.3.55 crores.

(iv) Estate Duty

In the course of test audit of estate duty assessments it was noticed that in 110 cases there was short levy of estate duty of Rs.0.60 crores.

State-wise Analaysis

While deficiencies and mistakes were generally noticed in all circles, maximum underassessment of tax was noticed in Maharashtra, West Bengal, Delhi Tamil Nadu, Gujarat and Madhya Pradesh in that order. In terms of the numbers of cases noticed, Maharashtra had the highest number followed by Tamil Nadu, Gujarat, West Bengal, Andhra Pradesh, Madhya Pradesh and Delhi.

Outstanding audit objections

1.20 Assessments completed by the Income-tax department are subjected to audit by the Department's own Internal Audit and test checked by the Indian Audit and Accounts Department (Statutory Audit) under the Comptroller and Auditor General of India. While the former conducts 100 percent audit of all immediate cases and all assessments under section 143(3), 143(1)(a) (October 1989-September 1990), the audit by I.A. & A.D. is carried out through test checks, designed to verify the adequacy and efficiency of systems and procedures. According to the Departmental instructions, objections raised by Internal Audit Department are to be attended to by the assessing officer within a period of three months, whereas audit observations of statutory audit are to be replied to within a period of six weeks. However, in the case of summary assessment cases, which had not been audited by the Income-tax Department, that Department has been taking the view that cases covered by Section 143(1) are not be scrutinsed to by them.

During 1990-91, the total number of audit observations pointed out by the Internal Audit Department was 17,230 with a money value of Rs.697.03 crores while the number of observations of statutory audit came to 19,387 with money value of Rs.489.13 crores.

As on 31 March 1991, a total number of 1,09,783 audit objections pointed out by both the Internal Audit and Statutory Audit, were pending for settlement. Of these, 10,654 major cases (with tax effect of Rs.10,000 and above, under the income-tax and Rs.1,000 and above under the other direct taxes) are of the Internal Audit, accounting for Rs.699.11 crores and 23,542 minor objections involving revenue effect of Rs.5.39 crores. The remaining 75,587 cases relate to statutory audit involving Rs.1,333.01 crores.

(i) Internal Audit

As per the information furnished by the Directorate of Inspection (Income-tax and Audit) of the Department, the number of major objections of the Internal Audit disposed of

during the four year period of 1987-88 to 1990-91 and the number pending as at the end of these years are given below:

Financial year	No. of cases for disposal and amount (in crores of rupees)	No. of cases disposed of and amount (in crores of rupees)	Percentage of disposal to total number of cases for disposal	No. of pending cases and amount (in crores of rupees)
1987-88	18,284 451.22	7,189 234.49	39 52	11,095 216.73
1988-89	18,840 411.75	7,974 200.89	42 49	10,866 210.86
1989-90	18,578 479.25	8,907 156.39	48 33	9,671 322.86
1990-91*	20,698 1017.36	10,044 318.25	49 31	10,654 699.11

Age wise analysis of the pending items at the end of 1990-91 and revenue effect involved are given below:

Year in which objection raised	No. of cases (Amount in crores of rupees)	Revenue effect
1986-87 and earlier years	197	2.82
1987-88	721	25.99
1988-89	1,428	45.77
1989-90	2,630	68.53
1990-91*	5,678	556.00
Total	10,654	699.11

The Public Accounts Commitee, in their 150th Report submitted to Eighth Lok Sabha in April 1989, had recommended that internal audit objections should also be analysed with reference to the year of assessment apart from the year in

* **Figures furnished by the Ministry of Finance are provisional**

which the objections were raised, so that greater attention could be given to the settlement of objections relating to earlier years, before they became time-barred for re-opening. Since the normal period available for re-opening of cases is four years, all objections pertaining to 1987-88 and earlier years should have been settled by March 1991, which is not the case, as shown above.

(ii) Statutory Audit

As on 31 March 1991, 75,587 objections involving a revenue of Rs.1333.01 crores, are pending for final action. The year-wise particulars of the pendency are as follows:

(a) Statement showing year-wise particulars of pendency of objections, as compared to the position as on 31 March 1990.

	Income-tax		Other Direct Taxes (Wealth-tax, Gift-tax and Estate Duty)		Total	
Year	Items	Revenue effect	Items	Revenue effect	Items	Revenue effect
			(Amount in crores of rupees)			
Upto 1987-88 and earlier years	40,165 (43,830)	267.82 (304.70)	8,923 (10,229)	36.43 (39.93)	49,088 (54,059)	304.25 (344.63)
1988-89	7,935 (9,911)	212.64 (247.30)	1,362 (1,836)	6.85 (7.76)	9,297 (11,747)	219.49 (255.06)
1989-90	15,632	800.53	1570	8.74	17,202	809.27
Total	63,732 (53,741)	1280.99 (552.00)	11,855 (12,065)	52.02 (47.69)	75,587 (65,806)	1333.01 (599.69)

Note: The figures in brackets indicate the position as on 31 March 1990.

During the year 1990-91 there was an increase in the number of outstanding objections by 9,781 (15 percent) items, and the revenue effect of the outstanding objections had increased by Rs.733.32 crores (122 percent) over that of the earlier year.

(b) There were 975 cases (as against 530 in earlier year) where the income-tax involved in each individual case exceeded Rs.10 lakhs. The charge-wise break-up of these cases are:

S.No.	Name of charge	Items	Amount (in lakhs of rupees)
1.	Maharashtra	275	19,133.75
2.	Uttar Pradesh	7	391.37
3.	Assam	21	1,283.56
4.	Bihar	25	5,971.10
5.	Madhya Pradesh	77	9,176.48
6.	Kerala	14	1,410.42
7.	West Bengal	153	10,572.80
8.	Rajasthan	14	106.22
9.	Tamil Nadu	107	3,762.35
10.	Karnataka	57	5,400.49
11.	Andhra Pradesh	21	473.88
12.	Gujarat	41	1,296.62
13.	Delhi	135	30,681.46
14.	Haryana	2	28.13
15.	Orissa	3	48.90
16.	Punjab	21	112.31
17.	Himachal Pradesh	2	55.07
	Total	975	89,904.91

(c) The particulars of the number of cases where the wealth-tax involved in each case exceeded Rs.5 lakhs are as under:

Sl.No.	Name of Charge	Item No.	Amount (in lakhs of rupees)
1.	Maharashtra	4	62.31
2.	Madhya Pradesh	9	650.36
3.	Andhra Pradesh	2	132.62
4.	Delhi	1	21.30
5.	Tamil Nadu	6	137.72
6.	West Bengal	3	66.44
7.	Karnataka	1	7.37
8.	Gujarat	3	66.50
9.	Rajasthan	1	40.99
	Total	30	1185.61

(d) The particulars of the number of cases where the total gift-tax involved in each case exceeded Rs.5 lakhs are given below:

Sl.No.	Name of Charge	Item No.	Amount (in lakhs of rupees)
1.	Maharashtra	6	374.65
2.	Tamil Nadu	7	205.19
3.	West Bengal	3	89.52
4.	Gujarat	8	181.94
5.	Haryana	1	32.98
6.	Karnataka	2	66.02
7.	Kerala	2	26.77
8.	Orissa	1	184.97
	Total	30	1,162.04

(e) The particulars of the number of cases where the estate duty invovled in each case exceeded Rs.5 lakhs are shown below:

Sl.No.	Name of Charge	Item No.	Amount (in lakhs of rupees)
1.	Tamil Nadu	1	6.94
2.	Andhra Pradesh	6	701.62
3.	Madhya Pradesh	1	46.81

4.	West Bengal	2	11.30
5.	Karnataka	2	12.82
6.	Rajasthan	4	117.43
7.	Kerala	1	10.08
	Total	17	907.00

Out of a total pendency of 75,587 cases, involving a revenue effect of Rs.1333.01 crores, 1052 cases (1.39 per cent) accounted for a revenue effect of Rs.931.60 crores (69.89 percent). The data given called for adequate attention to cases involving larger revenue effect by assigning priority in the matter of their settlement.

(iii) Steps taken to settle objections

The Action Plan Target of the department for 1990-91 provided for disposal of 100 percent of all arrear major audit objections. In respect of current objections raised by statutory audit upto 31 December 1990, replies are to be sent in 90 percent of the cases while the target fixed for major internal audit objections is 50 per cent.

(a) According to Quarterly Reviews of Internal Audit and Receipt Audit major objections of the Directorate of Income-tax (Income-tax and Audit) for the quarter ending March 1991, the position of Action Plan Target and achievement for the clearance of the major internal and statutory audit objections for the year 1990-91 was as under:

	Number for disposal (Amount in crores of rupees)	Number to be settled as per targets fixed	Number settled (Amount in crores of rupees)	Shortfall in targets	Shortfall percentage to target	Percentage of settlment to total number for disposal	Balance pending (Amount in crores of rupees)	Percentage of pendency
A. Internal Audit Objections								
Current**	11,027 (694.51)	5,513 (50%)	5,349 (138.50)	164	2.97	48.51	5,678 (556.00)	51.49 (80.06)

** Figures furnished by Ministry of Finance

Arrear	9,671	9,671	4,695	4,976	51.45	48.55	4,976	51.45
	(322.86)	(100%)	(179.75)				(143.11)	(44.35)
B. Receipt Audit Objections								
Current	12,939	11,645	4,977	6,668	57.26	38.47	7,962	61.53
	(763.97)	(90%)	(311.53)				(452.44)	(59.22)
Arrear	28,736	28,736	23,734*	5,002	17.41	82.59	5,002	17.41
	(939.52)	(100%)	(797.64)				(141.88)	(15.10)

The above data show that although a large number of cases were settled during the year, the targets were not achieved to the extent programmed.

(b) Remedial action barred by time.

The Central Board of Direct Taxes have issued specific instructions to take timely action on audit objections so as to avoid cases becoming time-barred leading to loss of revenue. The Public Accounts Committee (150th Report - Eighth Lok Sabha) have also recommended that the Board may review old outstanding objections in co-operation with audit.

In a few charges reviewed during the year 1989-90 and 1990-91 a number of cases where remedial action became barred by limitation, were noticed, even after the omissions were pointed out by Statutory Audit. The number noticed as a result of review of such cases alongwith tax effect involved in selected charges are as under :-

Sl.No.	Charge	No.of objections	Tax effect (in lakhs of rupees)
1.	Andhra Pradesh	542	14.68
2.	Haryana	125	16.09
3.	Madhya Pradesh	972	414.89
4.	Gujarat	4446	183.90

(iv) Non-receipt of Board's comments on draft paragraphs

Under the existing arrangement, sufficient time (about 7-8 months) is made available to the Income-tax department for dealing with all

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*** including 2,074 and 11,569 current and arrear objections respectively not accepted by the department but yet to be dropped by Receipt Audit**

important audit observations, having substantial tax effect so that Department's comments and Ministry's remarks could be incorporated in the Audit Report, while reporting such cases. However, despite Board's instructions that all draft paragraph cases should receive the personal attention of the Commissioners of Income-tax for expeditious action, inordinate delays continue to occur in the receipt of Department's replies.

The position regarding receipt of replies to draft paragraphs from the Ministry for the last 3 Audit Reports are as follows:

Report	Period of issue	Total Number sent	Replies received upto November/ December of the respective year	Final position
1988-89	January - July 1989	1,442	676(Dec.)	1,216
1989-90	January - July 1990	1,903	356(Nov.)	1,316
1990-91	January-July 1991	1,319	535(Jan. 1992)	

CHAPTER 2

SYSTEMS APPRAISAL

2.01 PURCHASE OF PROPERTIES BY CENTRAL GOVERNMENT

Introductory

2.01.1. Tax evasion leads to generation of black money and the operation of a parallel economy.Tax avoidance which circumvents the law legally is also undesirable. The Government had been trying to combat the two evils through legislative measures and by tightening the process of enforcement machinery.

A number of anti-tax avoidance/evasion measures were included in the direct tax laws on the basis of the suggestions and recommendations of the various committees and commissions appointed by Government. Notable among them are:

(a) the provisions to book understatements in value of immovable properties in the transfer deeds to relations and associate persons and cases where the declared consideration was understated in the document of transfer;

(b) the provisions requiring the production of a tax clearance certificate as a pre-condition to registration by the registering authority;

(c) powers of survey,search and seizure;

(d) acquisition of immovable properties whose values were understated in transfer documents;

(e) purchase of such properties by Central Government;and

(f) valuation of properties by an independent valuation cell.

The legislations

2.01.2 Taking note of the free play of unaccounted money in real estate

transactions, the law (1964) enabled the assessing officer to ignore the value shown by assessees in the transfer deeds and to substitute in its place the fair market value in order to determine the true amount of capital gains, in cases where the transferor and the transferee were directly connected with one another and the assessing officer had reason to believe that the transfer was motivated with the object of avoidance of tax or reduction of the liability to tax on capital gains.In certain other cases where, in the opinion of the assessing officer, the fair market value of the capital asset exceeded the value so declared in the instrument of transfer, the full value of the consideration shall be taken to be the fair market value as on the date of transfer and capital gains computed accordingly.

Under another provision with effect from 6 October 1964 the registering authority was not to register any document which purported to transfer, assign, limit or extinguish the rights,title and interest of any person to or in any property valued at more than Rs.50,000 (Rs.2 lakhs from 1 April 1988) without the production of a certificate stating that the transferor had paid all taxes or had made satisfactory arrangements for their payment.

For purposes of gift-tax, it was provided that where property was transferred otherwise than for adequate consideration, the amount by which the market value of the property exceeds the value of the consideration shall be deemed to be gift made by the transferor and charged to tax accordingly.

The legislation, as amended with effect from 15 November 1972, on the recommendations of the Direct Taxes Enquiry Committee (the Wanchoo Committee) in its Report on black money, empowered the Central Government to acquire any immovable property, where such property was transferred by way of sale or exchange and the consideration for such transfer was not truly stated in the instrument of transfer. The scheme provided for initiation of acquisition proceedings where the fair market value of the property

exceeded Rs.25,000, if the fair market value exceeded the apparent consideration, by more than 15 percent of such consideration and the object of understatement was to obtain undue tax advantage. From 1 July 1982, the area of operation was widened to cover transfer of flats in co-operative societies and companies, part performance sales under the Transfer of Property Act,1882 and long term (over 12 years) leases. With a view to eliminating unproductive work in a large number of small cases, the monetary limit was raised to Rs.1 lakh from 1 June 1984.

Direct Tax Laws committee in its Interim Report (December 1977) had however observed that these provisions had the immense capacity to generate paper work and litigation and could be potent tools of harassment and provide avenues for corruption. The Long Term Fisal Policy announced in December 1985 also noted the large potential in litigation and harassment involved in the scheme and the not so productive results, and in keeping with the new scheme formulated therein, discontinued the operation of the existing scheme of acquisition of properties in relation to transfers after 30 September 1986, and empowered the government with a pre-emptive right to purchase any immovable property, which was being transferred for a value exceeding Rs.10 lakhs on the hope that it would induce tax payers to disclose the true values of properties and eliminate litigations. These provisions were initially applied from 1 October 1986 to properties valued over Rs.10 lakhs in the 4 metropolitan cities and then extended to 24 other cities through notifications of 1987, 1989 and 1991.

Earlier in 1981, while the provisions regarding the compulsory acquisition of properties were in force, the Supreme Court, explaining the purport and intent of the earlier legislation on capital gains to reduce the incidence of tax by transfers to associates and relations and to prevent understatements in real values of properties transferred to any person, observed that the first part applied to cases where the

transferee is a person directly or indirectly connected with the assessee and where the object of the understatement was to avoid or reduce the income-tax liability of the assessee on capital gains and the latter, to cases where the actual consideration received by the assessee was not disclosed and the consideration declared in respect of the transfer was shown at a lesser figure than what had actually been received, and that the section did not intend to bring to charge any fictional receipt not accrued or received. According to the ratio of the judgement, the onus of establishing the understatement or concealment and that it was with a view to conceal income and to avoid or reduce the liability to tax on capital gains, was on the department and the burden could be discharged by the revenue by establishing facts and circumstances from which a reasonable inference can be drawn. The provisions were rendered inoperative by the tests laid down by the Supreme Court which were practically impossible to be proved and the provisions relating to the substitution of declared value by fair market value for the purpose of levy of capital gains were deleted from 1 April 1988, as apparently the responsibilty of discharging the onus of understatement was formidable.

Scheme of purchase of properties

2.01.3 The salient features of the scheme with effect from 1 October 1986 are:

(i) the provision enables the Central Government to make a simple purchase of a property already offered for sale;

(ii) there is no compulsory acquisition involved and hence no solatium is payable;

(iii) the provisions apply to the cities of Bombay, Calcutta, Delhi and Madras from the beginning i.e. from 1 October 1986; Bangalore and Ahmedabad from 1 October 1987; Lucknow, Hyderabad, Cochin, Coimbatore, Bhubaneswar, Cuttack, Patna, Kanpur, Jaipur, Chandigarh, Surat,Indore, Nagpur, Pune, Madurai, Trivandrum and Bhopal from 1 June 1989 and

Faridabad, Gurgaon, Ghaziabad, Baroda and Noida from 1 April 1991.

(iv) only properties worth above Rs.10 lakhs are at present covered by the scheme;

(v) the property purchased vests in the Central Government free from all encumbrances;

(vi) transfers to a relative on account of natural love and affection are outside the operation of the anti-tax evasion measure;and

(vii) non compliance or contravention of the prescribed procedure invites imprisonment upto 24 months and fine.

Objectives

2.01.4 The objectives of the scheme are:

(1) to counter evasion of tax through understatement of the value of immovable properties in transfer deeds;and

(ii) to check the proliferation of black money in real estate transactions.

Prescribed procedure

2.01.5 An appropriate authority is a quasi-judicial authority constituted under the Income-tax law to perform the functions regarding purchase of immovable properties, such as passing orders for purchase of properties, issuing no objection certificates and declarations regarding revesting of properties etc. For the purpose, the appropriate authority is vested with powers regarding discovery and inspection, summoning and attendance of witnesses and examination of witnesses under the Code of Civil Procedure Code, 1908 as are vested in a court. It consists of three members, two from the Indian Income-tax service Group A in the rank of Commissioner of Income-tax or equivalent or higher post and one from the Central Engineering service holding the post of Chief Engineer or any equivalent or higher post. There are at present 7 appropriate authorities located at Delhi, Lucknow, Calcutta, Madras, Bangalore, Bombay and Ahmedabad exercising jurisdiction over neighbouring cities covered by the scheme.

No transfer of any immovable property covered by the scheme shall be effected without first entering into any agreement for transfer between the transferor and the transferee at least three months before the intended date of transfer.

The agreement for transfer shall be in writing in the form of a statement (Form 37-I of the Income-tax Rules, 1962) and shall be furnished to the appropriate authority in duplicate within the prescribed period viz. before 16 October 1986 in a case where the agreement for transfer was entered into before 1 October 1986 in respect of the four metropolitan cities (No action in cases of belated compliance made on or before 15 November 1986), before 30 October 1987 in respect of agreements for transfer entered into in Bangalore and Ahmedabad cities, and in all other cases before the expiry of 15 days from the date on which the agreement for transfer is entered into.

On receipt of the statement (in Form 37-I) the appropriate authority may make an order, after recording the reasons, for purchase of the property at an amount equal to the amount of apparent consideration within a period of two months from the end of the month in which the statement is received. It is clarified that the properties to be acquired will be identified by the recognised statistical method of random sampling.

Where an order for the purchase of any immovable property is made, the Central Government shall pay by way of consideration, an amount equal to the apparent consideration to the person or persons entitled thereto, within a period of one month from the end of the month in which the immovable property is vested in the Central Government. If the Central Government fails to pay the amount to the persons or deposit the same with the appropriate authority within the specified period, the order to purchase the property will stand abrogated and the property will stand revested in the owner after the expiry of the period under a declaration made by the

appropriate authority in writing to that effect.

The person entering into an agreement in respect of which particulars (in Form 37-I) have been furnished shall not revoke or alter such agreement unless the appropriate authority has not made an order for purchase of the property by the Central Government and the period specified for making such order has expired or the order of the appropriate authority stands abrogated, and any transfer of any immovable property in contravention of these provisions shall be void.

A registering officer under the Registration Act,1908 is barred from registering any document of transfer of any immovable property exceeding the value of Rs.10 lakhs and no person shall do anything which will have the effect of transfer of any immovable property, unless the appropriate authority certifies that it has no objection to the transfer.

The order passed by the appropriate authority is final and conclusive and cannot be called in question in any proceedings under this act or any other law.

Any person who fails to comply with the provisions of Chapter XXC is punishable with rigorous imprisonment from 6 months to two years and is also be liable to fine.

Implementation

2.01.6 632 properties had been purchased for a consideration of Rs.232 crores. Of these, purchases in respect of 301 properties are under litigation.246 properties which had been purchased for an apparent consideration of Rs.94 crores have been sold at a profit of Rs.33 crores i.e. 35 per cent.

The number of properties purchased and sold in various places are; Bombay 120, Delhi 38, Madras 27, Ahmedabad 20, Bangalore 19, Pune 15, Calcutta 4 and Lucknow 3.

Scope of Review

2.01.7 This review attempts to make an evaluation of the anti-tax evasion measures through purchase of property introduced in

the Income-tax law with reference to their conceptual framework, objectives, implementation and the overall success. In so doing, effort has been made to identify any lack of overall cohesion while enacting the legislations and the extent of lack of co-ordination and co-relation between the different Government agencies connected with sale and registration of properties.

Statistical data

2.01.8 The following are the particulars of number of statements in Form 37-I received, number of no objection certificates issued, number in which purchase orders were passed, number in which writ petitions were pending and the number of properties sold in public auction, upto the end of February 1991:

Sr. No.	Location of appropriate authority	Cities	No. of statements in Form 37-I received	No. of NOCs issued	No. of orders passed	No. of suits pending	No. of properties sold
1.	Delhi	Delhi	2,354	1,905	123	85	38
		Jaipur	16	7	4	3	-
		Chandigarh	30	16	7	6	-
			2,400	1,928	134	94	38
2.	Bombay	Bombay	7,021	5,827	232	76	120
		Pune	916	647	44	14	15
		Nagpur	88	77	1	1	-
			8,025	6,551	277	91	135
3.	Calcutta	Calcutta	757	518	41	34	4
		Bhubaneswar	13	10	--	-	-
		Cuttack	--	--	--	--	-
			770	528	41	34	4
4.	Madras	Madras	1,224	895	50	14	27
		Coimbatore	71	47	7	2	-
		Madurai	7	7	-	-	-
			1,302	949	57	16	27

5.	Bangalore	Bangalore	2,701	1,312	64	40	19
		Hyd'bad	259	182	6	6	-
		Cochin	62	35	1	-	-
		Trivandrum	43	8	1	1	-
			3,065	1,537	72	47	19
6.	Ahmedabad	Ahmedabad	321	273	38	10	20
		Surat	35	33	2	1	-
		Indore	56	55	-	-	-
		Bhopal	7	7	-	-	-
			419	368	40	11	20
7.	Lucknow	Lucknow	43	18	8	5	3
		Kanpur	25	13	1	1	-
		Patna	48	20	2	2	-
			116	51	11	8	3
	Total	16,097	11,912	632	301	246	

These 246 properties with apparent consideration aggregating to Rs.94.10 crores were sold for Rs.127.20 crores and the Government made a profit of Rs.33.10 crores, while no objection certificates were issued in 74 percent of the cases (11,912 out of 16,097 statements received) during four years (1986-90) operation of the scheme.

Highlights

2.01.9.(1) Chapter XXC dealing with the scheme of purchase of properties in certain cases of transfer by the Central Government was operative from 1 October 1986. The provisions do not require allowing opportunity to be heard, nor allow any right of appeal. However, the constitutional validity of the scheme has been challenged, inter alia, on the ground that it infringes the right to buy/sell property. The matter remains sub judice. Some individual cases have also been challenged on procedural grounds like orders passed without show cause notice or hearing or issuance of non-speaking orders.

(2) The new scheme is applicable to immovable property offered for sale at value above Rs.5 lakhs as may be prescribed by the Government. It replaced the earlier

provisions for acquisition of properties applicable to the entire country which were proving time-consuming and ineffective with endless litigation and harassment. The Government put the cut off level of consideration at Rs.10 lakhs, initially applied the scheme to the four metropolitan cities of Bombay, Delhi, Calcutta and Madras from 1 October 1986 and thereafter till April 1991, extended it to 24 more cities. Thus coverage of the scheme has remained severely restricted and similar transactions outside the few notified cities remain beyond the reach of the scheme thereby appearing to undermine the equity of the scheme.

(3) As at present the scheme applies to the transfer of immovable properties of value exceeding ten lakhs rupees in each case. There has been no move to readjust the financial limit, having regard to the magnitute of operation of the scheme etc. and taking note of shift in real estate prices. Further, under the rules framed under the Act, the value has been prescribed as the apparent consideration of the relevant property. Consequently where the stated consideration of a property is deliberately kept below the prescribed limit, the case automatically goes out of the purview of the scheme. Further, in line with the judgement of the Calcutta High Court, the scheme is not attracted where jointly-held property is transferred if the share of each co-owner is below the stipulated monetary limit, even though there has been no partition physically identifying each share. There have also been cases of transfer of the same property to the same party through more than one document, each showing apparent consideration below Rs.10 lakhs.

Auction cases too remain outside the scope of the scheme; the Bombay High Court held that there can be no agreement between parties in an auction sale.

(4) The Central Government have so far constituted seven appropriate authorities located at seven different cities and have defined their jurisdiction on the basis of

their geographical location. Available statistics revealed wide disparities in the work-load of the appropriate authorities, which varied from 0.7 percent at Lucknow to 50 percent at Bombay.

(5) The institution has been in force for over four years. The Central Board of Direct Taxes has not so far undertaken any evaluation of the scheme nor has it prescribed any work norms for the appropriate authorities or the priorities to be followed in the disposal of the cases.

(6) According to available statistical data, upto the end of February 1991, the appropriate authorities had issued 11,912 no objection certificates out of a total of 16,097 intimations in Form 37-I received since inception, (around 74 percent) and had passed orders for purchase in 632 cases. This was about 4 percent of the total number of cases processed. 246 properties with an apparent consideration of Rs.94.10 crores were sold for Rs.127.20 crores, making a profit of Rs.33 crores, a profit margin of 35 per cent. During the financial years 1988-89 and 1989-90, 95 and 123 properties only were purchased and the value of the properties so purchased amounted to Rs.108.71 crores. Of these in 52 (24+28) cases, the value exceeded Rs. 50 lakhs each.

(7) Under the scheme, no transfer of any property of value exceeding rupees ten lakhs shall be effected without entering into an agreement in the form of a statement in Form 37-I before three months of the intended date of transfer and furnishing the same to the appropriate authority within 15 days of the date of entering into the agreement. The appropriate authority has the option of passing the order for purchase within two months from the end of the month in which the statement is received. Failure to furnish the statement makes the defaulter liable to rigorous imprisonment upto 2 years (minimum 6 months) and fine. The Central Board of Direct Taxes has however not laid down any procedure for watching and reporting the receipt and disposal of these statements. Test-check

revealed that during 1986 to 1990 there were delays ranging from 3 days to 1190 days in furnishing the statements, but proceedings against the defaulting parties, were not initiated although the Board had in 1987 directed identification of defaulters. The reasons for not initiating action were not on record.

(8) Test-check revealed cases of transfers without the requisite statements in Form 37 I being filed. Under the new scheme, in the absence of liaison with the registering authorities, there is no machinery to ensure that the statements in Form 37-I were filed in all liable cases and that no property was registered without a no objection certificate.

(9) As per CBDT instructions, properties to be purchased were to be identified by statistical method of random sampling. Upto February 1991, in 632 cases only out of 16,097 statements in Form 37-I received, purchase orders were issued. There was no indication of application of statistical sampling in the process of decision making. It is also not clear as to how the appropriate authorities are going about in initial screening of the Forms 37-I received, identifying possible cases of gross understatement of the considerations, selecting cases for reference to the valuation cell and deciding on cases for pre-emptive purchase.

(10) The appropriate authority, on receipt of the statement in Form 37-I has, within 2 months, to issue either the pre-emptive purchase order or the no objection certificate on the strength of which registration of the sale deed would take place. It was however seen that the appropriate authorities simply rejected/filed a large number of Forms 37-I on the ground that these were defective or incomplete without any further action. It could not have been the intention of the legislation that some defects in the forms cannot be got rectified or points of doubt clarified. Such action may not promote the objective of the

scheme, apart from the inconvenience that may be caused to parties of property deals.

(11) Out of 16,097 cases, processed during October 1986 to February 1991,in 632 cases with apparent consideration of Rs.232.12 crores (an average price of Rs.37 lakhs per case), purchase orders were passed. Of these 246 properties with apparent consideration of Rs.94.10 crores were sold. Apparently, high value properties were ordered for purchase. In bulk of the other cases (11,912 i.e.74 percent) no objection certificates were issued. The aggregate apparent consideration of these properties and the range of the value of the properties in these cases are not available. Having regard to the objective of the legislation as a deterrent to the widespread operation of black money, more intensive scrutiny of these cases to ascertain the true market prices was called for so as to identify the real tax evaders.

(12) In practice, the appropriate authorities have had considerable difficulty in handling cases of transfers by way of lease/sub lease of industrial undertakings lock, stock and barrel, agreement between land owners and developers/builders for construction of complexes conditional transfers or transfers of tenanted properties.

(13) Test check revealed that the reserve price for sale is being fixed generally by adding 15 percent to the apparent consideration. Thus the department is not taking note of the fair market value as assessed by its own valuation officers on which the decision to purchase is based. Even then, many of the cases attracted only one or two bidders.

(14) The results of the review disclosed lack of co-ordination between the Urban Land Ceiling authorities, the registering authorities, the tax clearance officers and the assessing officers due to want of either a legal provision or a proper mechanism. Cases were noticed where properties were purchased for a price much in excess of the compensation payable under the relevant Urban

Land Ceiling Act. For want of such co-ordination, there has also been substantial non/short levy of capital gains and/or gift tax.

(15) The scheme of pre-emptive purchase of properties involves an elaborate procedure starting from receipt of Form 37-I and ending in auction sale of the concerned properties. Though four years have elapsed, the Central Board of Direct Taxes have not laid down any guidelines to regulate the scheme and prevent slippages. In its absence, the appropriate authorities have maintained their own registers. But laying down uniform registers etc. would be desirable.

(16) As per information furnished by the Ministry of Finance, under the erstwhile scheme of acquisition of properties during the six years 1985-86 to 1990-91, out of a total of 9,72,730 intimations received in 1,53,162 cases notices were issued and 92,330 cases were dropped. In a small number of 490 cases, order were passed. The number of properties actually taken over was only 92. Under the new scheme of purchase of properties by the Central Government out of 16,097 intimations received in 11,912 cases no objection certificates were issued, purchase orders were passed in 632 cases (4 percent) of which 301 cases went in litigation. The statistics reveal that the new scheme too suffers from voluminous paper work and litigation, despite having been limited in scope. A review of the scheme in its existing form may be warranted keeping in view the unproductive work and the available manpower.

To sum up, having found that the earlier scheme of acquisition of properties had led to endless litigation and proved ineffective, Government formulated the scheme of pre-emptive purchase of properties in the hope that it would induce the transferers to state the true amounts of consideration in transfer deeds, or else would enable the Central Government to purchase the properties at the stated consideration with no right of any further appeal. Test review, however,

suggested that when compared with the scheme of acquisition of properties on the whole, the scheme could not have been a success on various counts:

- the scheme is beset with litigation despite a specific provision denying any right of appeal.

- apparently, the scheme had no safeguard against deliberate understatements in apparent consideration below the limit prescribed under law either individually or by splitting up of the properties for sale, or in not filing of the prescribed statement in violation of the statute.

- there was no evidence of principled selection of cases for purchase, which tended to erode the objectivity of the system.

- the scheme has not effectively tackled cases of auction sales, transfers through builders/developers etc.

- the implementation of the scheme was deficient in many respects nor was it monitored by issue of appropriate guidelines and procedures.

Detailed Review

2.01.10.(a) Extent of coverage

Position of the legislation

Prior to 1 October 1986, from which date the provisions for pre-emptive purchase become operative, the erstwhile provisions on compulsory acquisition held the ground and were applicable throughout the country. Even though the latter provisions are no longer applicable except for past cases initiated before 1 October 1986, the operation of the new provisions remains rather restricted. These apply only to properties with apparent consideration above Rs.10 lakhs. Further, only four metropolitan cities were covered initially from 1 October 1986 and thereafter till date, another 24 cities have been brought within the purview of pre-emptive purchase. Thus, a very small portion of real-estate transactions attracts attention which is not in tune with the general objectives of the legislation.

(b) Stated consideration below Rs.10 lakhs by splitting up or otherwise.

Even in respect of the few cities to which these apply, the provisions for pre-emptive purchase are activated only where the stated consideration for the transfer of property in the agreement entered into is above Rs.10 lakhs. Bulk of the transactions therefore falls outside the scope of these provisions. There being no check at all, from the angle of pre-emptive purchase, of cases below the monetary ceiling even on a small percentage of random sampling, there is free scope of understating the consideration so as to bring it below Rs.10 lakhs for any transaction by itself or by way of splitting/division of the properties.

The Calcutta High Court had also held, in the case of M/s.Multicon Builders Pvt.Ltd that no action was possible in cases of splitting. Consequently, properties jointly owned by more than one person, even where these were not formally partitioned among co-owners whose shares were not physically identifiable, were being transferred, without reference to the appropriate authority, to the same parties though execution of separate documents by each co-owner showing the apparent consideration in each document below Rs.10 lakhs, though the transactions really involved transfers of properties each costing well above Rs.10 lakhs. There are also cases of the same property owned by one individual having been transferred to the same party in parts by executing more than one document, each exhibiting apparent consideration below Rs.10 lakhs. In Karnataka, Madhya Pradesh, West Bengal and Kerala circles, 14 properties, jointly owned by several individuals with aggregate apparent consideration of Rs.316.84 lakhs but each property valuing more than Rs.10 lakhs, were sold by either transferring the individual shares of the co-owners in separate documents or gift deeds or in parts on different occasions with proportionate apparent consideration in each individual case below rupees ten lakhs. In one such case in Kerala circle a person owning a 3 storeyed building

on land admeasuring 38.10 cents by a deed executed on 2 May 1990, transferred the land and the ground floor of the building for a consideration of Rs.9 lakhs. On 3 August 1990, the remaining floors of the same building were transferred to the same transferee for Rs.4 lakhs, the total consideration aggregating to Rs. 13 lakhs.

Auction cases

(c) It was held by the Bombay High court, in *Abdus Samat Haji Adam Kantharia and others vs. Union of India and others that since there would be no agreement between the parties in the cases of auction sales, these would not fall within the purview of the scheme of purchase of properties. There has been no definite procedure for dealing with such cases in the context of the requirement that documents transferring immovable property of value exceeding the prescribed amount can be registered only on the strength of no objection certificate issued by the competent authority on receipt of the agreement for transfer. It was seen in audit that in some of these cases, statements in Form 37-I were being submitted to the appropriate authority who also issued no objection certificates while some did not come up at all before the appropriate authority.

In auction cases, while there may be no formal agreement prior to the auction, a specific provision for obtaining no objection certificate from the Income-tax Department before registration of the transfer following auction may not pose any difficulty.

Validity of legislation/ action thereunder under challenge

2.01.11 The provisions make the orders of the appropriate authority final and conclusive, not to be questioned in any proceeding. However, remedy by way of writs remains open and the constitutional validity of the scheme is not yet settled. As stated in Para 6, as many as 301 out of 632 cases of purchase orders remain under litigation. The validity is challenged on mainly two grounds, of the provisions being **ultra vires** the

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* 135-ITR-77

rights conferred under the Constitution or the scheme being beyond the legislative competence of Parliament. Further, in some cases the orders of the competent authorities have been challenged even on other grounds, including procedural, such as lack of show cause notice, order without stating reasons etc. Thus, though under the legislation the orders of appropriate authorities shall be final and conclusive and shall not be called in question under any law, the provision has become practically otiose. To illustrate, in two cases of Uttar Pradesh, the transferors filed writ petitions and stalled further action by the appropriate authority, in one due to the purchase order having been passed without giving show cause notice or hearing the parties and in the other, due to the purchase order having failed to mention specific reasons.

In some cases, even tenants moved the courts, though their rights were coterminus with those of the landlord. For instance, in Tamil Nadu circle, two tenanted properties were purchased by the Goverment for an apparent consideration of Rs.52.50 lakhs. The tenants refused to hand over possession and moved the High Court. Similarly tenants of six properties (purchased price Rs.320.16 lakhs) in Karnataka circle had filed writ petitions challenging issue of purchase orders without hearing them. It was however seen that in Gautham's case challenging the constitutional validity of the provisions of the scheme, the Attorney General had stated before the Supreme court that they had no intention to evict the tenants from the buildings purchased under the scheme. This may jeopardise government interest in these cases. The Govt. has not been able to proceed further against the tenants and get vacant possession.

Three interesting cases of non-speaking order of Maharashtra circle are given below:

(a) According to an agreement dated 15 May 1989, in one case in Maharashtra circle, M/s. CH sold a row house consisting of ground floor and upper floor with a built up area of

3,143 sq.ft. including lift, staircase and open terrace. The sale included garden-cum-parking, etc. The sale was made to M/s. AL for an apparent consideration of Rs.1.21 crores (discounted value of Rs.1.19 crores determined at the rate of Rs.2,833 per sq.ft.). The valuation officer pointed out in his report that the sale instances per sq. ft. in the same building in respect of flats were as high as Rs.4526 and Rs.4472 and therefore the sale instance at the declared rate of Rs.2,833 per sq.ft. was low. The Income-tax Officer attached to the appropriate authority had also pointed out that they had received a case in respect of a flat in 7th floor of the building at the rate of Rs.3,331 per sq.ft. as on 30 May 1989 and, therefore, the rate of Rs.2,833 per sq.ft. was low. In his order of 5 July 1989 the appropriate authority had only observed that there was no case for purchase on merits without making a speaking order and ordered for issue of no objection certificate. While the rates of flats taken for striking the comparative price were very high,the value of present row house should not have been lower, having regard to the facilities it commanded.

(b) In another case in the same circle, the development rights of the land admeasuring 15,840 sq.ft. (declared F.S.I. 15,800 sq.ft.) were agreed to be transferred for a net consideration of Rs.48.19 lakhs (excluding share of stamp duty to be borne by the vendor) vide agreement dated 18 April 1988 by a vendor to a private limited company of builders at the rate of Rs.304 per sq.ft. (F.S.I.). The valuation officer pointed out **inter alia**, in his investigation report on 7 June 1988 that the rate declared in the agreement was low compared to the rate of 411 per sq.ft. (F.S.I.) in a comparable instance of sale of land in a similar locality in January 1988. Besides, the property was in a better footing in as much as the building plan was approved and foundation work had also been partly completed. He had, therefore, recommended further necessary action. The Deputy Commissioner of appropriate authority upheld the view and on 17 June 1988 worked out the understatement to

the extent of 35 percent. The property was jointly inspected by members of the appropriate authority and orders for issue of no objection certificate were issued on 22 June 1988 without recording any speaking order and without spelling out the reasons for not resorting to pre-emptive purchase.

(c) By an indenture dated 30 March 1989 a reputed Industrial Research and Development Centre in Bombay entered into an agreement with a lessee engaged in communications and system studies for a lease of an area admeasuring 9803.25 sq.ft. of super built up area on 18th and 1st floors of a high raise building in Bombay for 60 years for an apparent consideration of Rs.1.76 crores at Rs.1,800 per sq.ft. super built up area. This amount was payable over a span of 14 years in 15 instalments of Rs.11.76 lakhs. The first instalment was payable by 1 March 1989 and the balance 14 on 1 March of each subsequent year. The discounted value of the apparent consideration worked out to Rs.1.09 crores and rate per sq.ft. of super built up area worked out to Rs.1109 per sq.ft. The transfer included parking space also the details of which were not specified. This would further reduce the rate of lease.

It is seen from the records that transferee has entered into another agreement called `Service agreement' with the transferor on 14 July 1989 for providing the services of (i) Computer Centre (ii) International Communication Centre and (iii) Document Reproduction Centre subject to allocation of suitable accommodation to transferee. Accordingly, the transferor provided the above accommodation to transferee and charged Rs.1,800 per sq.ft. as prevailing in the year 1986. The valuation officer had calculated a rate of Rs.3,048 per sq.ft. in another case in the same building, compared to which the discounted rate in the present case (Rs.1,109 per sq.ft.) worked out to about 36 percent. By applying the rate of Rs.3,048 per sq.ft. to the present case, the apparent consideration should be about Rs.2.98 crores as against the discounted value of Rs.1.09 crores.

The appropriate authority decided on 23 June 1989 to issue no objection certificate to the above transaction (case No. 4302) on the ground that the facts had been carefully gone through including the papers on the file and the agenda for the meeting held on 20 October 1987 of the Managing Committee which included a representative of Government of Maharashtra. The rate of Rs.1,800 per sq.ft. of super built up area was agreed upon much prior to the service agreement.

The lease agreement was entered into on 30 March 1989 and the service agreement was entered into on 14 January 1989. According to the lease agreement the rate at which the property was to be sold was determined as Rs.1,800 per sq. ft. The Deputy Commissioner in his note dated 6 June 1989 drew the attention of the appropriate authority to the original proposal and revised proposal of August 1986 made by the transferee. However, till October 1986 the rate at which the space was to be transferred was not determined. The Deputy Commissioner further observed that there was nothing on records to show that Rs.1,800 per sq. ft. was the rate at which the transfer was to be made to the transferee. The time gap between the lease agreement and the service agreement was too short and it could not be taken as the rate of Rs.1,800 per sq.ft.was determined before entering the service agreement. Neither lease agreement nor service agreement referred to negotiations in 1985 or 1986. The terms of service agreement was 15 years or to expire earlier, whereas the lease agreement for the premises was for 60 years. The transferor was not bound to utilise the services of transferee exclusively and the term of agreement could be varied on mutual consent.

The Deputy Commissioner further observed that resort to the service agreement by the parties was a manipulative tactic and such huge difference in the apparent consideration of Rs.2.99 crores, compared to the market rates could not be explained away by the service agreement. Such huge difference could probably finance the whole project of the transferee. The benefit to the centre was

negligible. The services of the transferee were not indispensable as the agreement contained provision for altering the terms and even doing away with the services of the transferee. The Centre's occupants and users were also not party to the service agreement and hence not bound to avail the services of the transferee. The Deputy Commissioner felt that it was to defeat such manipulative designs that the legislature had provided for pre-emptive purchase powers, as vesting of properties free from all encumbrances in the Central Government would reach some finality. He further observed that even if it came to litigation, the case would be worth fighting for in the courts.

In the light of the above observations the no objection certificate issued by the appropriate authority was not explained.

Cases of lease/sub-lease power of attorney, tenanted properties and agreements with developers/ builders

2.01.12 Cases of transfers by way of lease/sub-lease or power of attorney, of industrial undertakings as going concerns, by agreement between land owners and developers/builders for construction of complexes on plots etc. have generally proved somewhat difficult. Often, some of the conditions of the agreements deterred the concerned appropriate authorities from interfering in the transactions. The same happened in respect of tenanted properties and also where owners had entered into agreements with developers/promoters of apartment buildings, the main features of which are :

(i) The owner retains certain percentage of interest in the undivided share of land.

(ii) The developer acquires the right to exploit the entire land for construction of high rise buildings.

(iii) The owner is obliged to transfer the interest in the undivided share of the land surrendered by him, to the developer or his nominees either in full or in piecemeal at a future date(s) as required by the developer.

(iv) Consequent upon the surrender of certain percentage of right in the undivided share of the land, the transferor receives as consideration:

(a) cash which is considerably less as compared to the total consideration.

(b) specified built up area on the structure to be put up by the developer with covered car sheds, etc.

(c) refundable caution money deposit.

Some of the agreements to transfer do not contain the value of the built up area exchanged for the land. And these "agreements to transfer" are usually not registered in the offices of the concerned sub-registrars.

It is a moot point whether the appropriate authority can afford to purchase a certain percentage of the undivided share in the land in such cases and auction it. The operation of the scheme was to that extent rendered ineffective. Many cases came to notice where transactions of the nature stated above did not come up before the Appropriate Authorities, or where the Appropriate Authority felt constrained by the conditionalities involved. Some illustrative cases are given below:

Karnataka circle

(i) A transferor had leased out the ground floor of a five storeyed building on a monthly lease rent of Rs.37,976 for an initial period of four years renewable by one more year by a lease deed dated 28 August 1989.The statement in Form 37 I filed by both the transferor/lessor and lessee was rejected as the apparent consideration in respect of this lease involving only one floor of the building was less than Rs.ten lakhs, though the market value of the entire building with all the five floors was more than Rs.ten lakhs.

The transferor had obtained the property by means of a power of attorney dated 15 June

1989 executed in his favour by all the fifteen owners of the property. By this power of attorney, the transferor was vested with full enjoyment of the property for an unlimited period and could deal with the property in any manner with the exclusion of right to sale.The power of attorney evidenced by a notary was not registered. The transfer of this property to the transferor by the owners of the property did not come up before the appropriate authority.

(ii) A vendor entered into an agreement on 12 April 1989 with a transferee for the transfer of an immovable property for a consideration of Rs.92.40 lakhs.It was seen from the agreement that the two owners of the immovable properties who were not citizens of India had executed an irrevocable power of attorney on 26 March 1988 in favour of two persons in Bangalore.The transfer of property through irrevocable power of attorney on 26 March 1988 was not brought to the notice of the appropriate authority.The agreement dated 12 April 1989 revealed that the vendor had entered into agreement with the owners of the property on 25 August 1988, 25 November 1988, 27 December 1988, 23 February 1989 and 27 March 1989. On none of these occasions the transfer was brought to the notice of the appropriate authority.

(iii) A transferor entered into an agreement on 5 February 1990 for the transfer of an immovable property at a consideration of Rs.32 lakhs. Under the agreement, the transferor had to complete the construction of flats and hand them over to the transferee within 24 months from the date of agreement. Even though the apparent consideration was considered low, the approrpiate authority deemed it fit to issue "No Objection Certifciate" for the reason:

`We also kept in mind the problems the Central Government may have to encounter, if property under consideration is purchased. The Central Government had to shell down the entire consideration within a month and wait for the transferors for at least 24 months to construct and hand over the flats.

Conceivably the construction and handing over of flats may take many more months and the transferor may not be at loss for the delay notwithstanding the penal clauses in the agreement.The transaction is fraught with too many imponderables and risks for the Central Government.'

(iv) An individual entered into an agreement on 23 December 1989 for the transfer of an immovable property for a consideration of Rs.83.30 lakhs. But the occupant of the building enjoyed right of occupancy for life. As her right to occupy is an encumbrance to the property, the appropriate authority chose not to interfere even though the land rate as per the agreement was only Rs.360 per sq.ft.while sale instances in the neighbourhood ranged between Rs.601 to Rs.642 per sq.ft.

(v) In respect of a "going" industrial unit in an area of 9 acres and 38 guntas belonging to a manufacturing company, an agreement to transfer alongwith its operational staff, machines etc., to a transferee company was executed on 5 Decmber 1988 as it was incurring heavy loss, for an apparent consideration of Rs.60.00 lakhs.It was said that it would take a minimum of 2 years for the transferee company to put the unit on an economically viable base. Besides, the transfer was to be effected on a specific date to avoid complications arising from the provisions of the Industrial Dispute Act. Even though the under-statement of apparent consideration was estimated at Rs.15.37 lakhs, no objection certificate was issued because of "exigencies of the situation and the unit is incurring heavy loss".

(vi) An area of 64,405 sft. of land with an old bunglow therein was the subject matter of transfer between two parties.One of the conditions of transfer was that the transferee should, at his expenses, provide within nine months an accommodation of 10,000 sft. in the vacant portion of the land under transfer to a beneficiary of the property covered by sale for a period of 20 years on a monthly lease rent of Rs.2,000. Despite such

conditionality, the appropriate authority, Bangalore issued the purchase order in June 1988. However, the transferor challenged it in July 1988. Pending disposal of the writ on the constitutional vires of the scheme, the Supreme Court authorised the transferor to put up a bunglow at her cost and risk.

(vii) The tenants of six properties purchased by the Central Government at an aggregate consideration of Rs.320.16 lakhs had filed writs individually in the Karnataka High Court questioning the orders of the appropriate authority for purchasing the properties without hearing them. Payments aggregating to Rs.216.55 lakhs were made during September 1989 to the transferors under bank guarantee in respect of three properties and between April 1988 and March 1990 without bank guarantee in the remaining three cases. In the context of the committment made by the Attorney General to the Supreme Court in Gautham's case, Government interest may suffer. Incidentally, the department is not in receipt of rent from these tenants nor has the department raised any demand in this behalf. In at least four of the six tenanted properties dealt with above, the original transferees were developers/builders. In such cases,the probality of the developers having bought the right of the tenants by promising them accommodation elsewhere cannot also be ruled out.

(viii) An owner of a piece of land entered into an agreement with a developer on 21 March 1990 according to which the former consented to exchange two thirds of his interest in the undivided share of the land for one third of the built up area. In pursuance of this agreement, the developer took possession of the land. But this agreement had not come up before the appropriate authority.

Uttar Pradesh circle

In one case in Uttar Pradesh circle, a transferor entered into an agreement with a builder on 27 May 1988 under which the

building was to be constructed by the developer and the transferor was to get one-third of the constructed area in the building as apparent consideration for the land measuring 35,794 sq.ft. The parties submitted Form 37-I in June 1989 without mentioning the monetary equivalent of the apparent consideration. As there were other discrepancies also, the form was treated as incomplete and was filed. Neither any order for purchase was passed nor was any no objection certificate issued to transferor. Subsequently, when in September 1989 the Form No. 37-I was submitted, the case was not considered fit for purchase in view of the inherent difficulties in exercising the right of purchase in the development agreement, in getting a bidder for the property in auction and in evaluation of monetary equivalent of the apparent consideration.

Madhya Pradesh circle

Four persons who co-owned a land admeasuring 25,552 sq. ft. with old super-structure entered into an agreement with a company in August 1986 for an apparent consideration of Rs.17.01 lakhs at Rs.66.57 per sq.ft. for land. On taking possession of the land, the company undertook the construction of a multistoried complex. On the basis of Form 37-I filed by the transferor on 5 July 1989, valuation officer reported on 27 July 1989 that the price of the property was grossly understated as the prevailing rate as per sale instances of May 1986 in the same locality was Rs.97.58 sq.ft. which would work out the value of the property at Rs.25.01 lakhs. It was however observed that as per record of the registering authority on 19 May 1989, the co-owners had already executed and got registered a deed to convey and transfer the individual proportionate share in respect of one apartment constructed on the said property. The developer was a party to the transfer deed as a transferor and had also received a consideration of Rs.9 lakhs. The flat constructed on the land was transferred without any sale deed in respect of the land. It was ascertained from the records of the assessing officer, Indore that he had issued

the tax clearance certificate on 30 March 1989 and that the transferors were not previously assessed to income-tax on capital gains or business income due to lack of co-relation between the two wings of the department.

No action on delayed submission of Form 37-I

2.01.13(a) The statements in Form 37-I are to be furnished to the appropriate authority within 15 days from the date of entering into the agreement for transfer of property. Failure makes the parties liable to rigorous imprisonment between 6 months and 2 years and levy of fine. Test check in **Madhya Pradesh, Maharashtra, Kerala, West Bengal and Gujarat circles** revealed delays in 9,5,10,104 and 32 cases ranging from 3 days to 1190 days. However, penal action was not initiated in any of these cases.

(b) Filing of defective/incomplete forms without further action

In **Tamil Nadu circle**, 166 applications (Form 37 I) for transfer of immovable properties were rejected as defective (out of a total 954 forms received) due to defective or unclear title of the transfer, non-signing of the forms, not specifying clearly the apparent consideration, discrepancy in the extent of property, non-furnishing of particulars of transferor/transferee, etc. In one case, one application where the apparent consideration was Rs.30 lakhs was invalidated on the grounds that there was dispute between the parties, the form was submitted belatedly and some important documents were not furnished. The transferee alleged that he had thereby lost a valuable right under the Specific Relief Act and the transfereor demanded more money.

In **Delhi circle**, 240 applications were filed during the period from October 1986 to 31 March 1990 as the relevant forms were defective. It is noticed that the department did not take any follow up action in such cases. However, in five cases where the forms were not signed and verified as required under the law, were not accompanied by a copy of agreement to sell, where the apparent

consideration was not mentioned in monetary terms, prosecution proceedings under Section 276 AB were initiated while in four other similar cases no action was taken.In five other cases (four where the statements were not signed, etc and were belated) the said market values were determined by reference to the valuation cell or independently, but no action was taken though the values were found much higher than the apparent consideration.

In **Karnataka circle** of the 617 statements in Form 37 I received by the appropriate authority to end of March 1990, 148 statements were rejected on the ground that the appropriate authority could not on the basis of the particulars available to it, decide to issue either an order to purchase or a no objection certificate. The main reasons for rejection of the statements are:

(i) clearance of Urban Land Ceiling Authority was not obtained,

(ii) clearance from the Reserve Bank of India under FERA was not obtained,

(iii)title to property was not clear/was questionable, and

(iv) inconsistencies existed between the statement and the agreement to transfer.

In **West Bengal circle**, 150 statements out of 666 statements were invalidated during the last four years (1986-87 to 1989-90) as being incomplete or defective. In two cases the statements were rejected, as apparently the agreements for transfer were not legally enforceable documents carrying a marketable and subsisting title in regard to the property free from all encumbrances.

It could not have been the intention of the Government to debar the appropriate authorities from getting the defects rectified so as to take a final decision regarding purchase of the property. Further, it is not clear as to how fulfilment of the objectives of the provisions is promoted by such filing of the forms without follow up

action. Besides, the appropriate authority is required to issue the order, if the property is to be purchased within 2 months from the close of the month in which the statement in Form 37-I is received. Otherwise a no objection certificate is to be issued permitting registration of the transfer of the property. Action, as taken in these cases, does not fall under either of these two categories and is apparently beyond what was contemplated.

(c) Selection of cases for purchase:

There is no provision in law nor any guidelines of the Board in regard to the selection of cases for purchase, except that the random-sampling method would be followed. It is not clear as to (i) how the Departmental authorities are screening the cases from the details in Form 37-I for detailed enquiry (ii) how and on what basis cases are identified for reference to the valuation cell and (iii) the basis on which purchase is decided upon in some cases. Random sampling does not seem to have been resorted to, nor has there been any attempt to establish liaison with other authorities such as the State Registration authority to identify cases where the fair market value, in the opinion of the Registration authority, was higher than the declared sale consideration. Some illustrative cases are :

Maharashtra circle

A flat in prestigeous locality was agreed to be transferred by an agreement dated 14 September 1985 for an apparent consideration of Rs.30 lakhs. The appropriate authority observed that the Form 37 I and the agreement accompanying did not indicate the area of the flat and the rate at which the property was proposed to be sold. The authority, however, issued no objection certificate on 27 January 1987 without apparently going into the reasonableness of the apparent consideration of the property and without ensuring that the value of the property was not understated.

Gujarat circle

A test-check of 69 cases of valuation reports received from the valuation cell of the department upto 31 March 1990 (excluding those which were purchased by the department) in respect of cases referred to them for valuation revealed that values determined by valuatioan cell of the department were higher than the apparent consideration in respect of 66 properties at 1.20 percent to 66.66 percent. Only nine of these properties were acquired by the Government.

Delhi circle

No objection certificates were found issued in the following cases:

(i) In two cases,Form 37 I only indicated that the agreement would be entered into later and there was no subsisting agreement.

(ii) In six cases, the allotments being provisional as per allotment letters, could be stayed and there was no approved building plan etc.

(iii) In two cases the fair market values had been worked out at Rs.419.85 lakhs and Rs.527.60 lakhs against the apparent consideration of Rs.322.94 lakhs and Rs.440.15 lakhs.

(iv) In another case the transferor had not acquired the right in the property as succession certificate had not been issued.

Non-initiation of appropriate proceedings

2.01.14 Where an immovable property is situated within the local limits of the jurisdiction of more than one appropriate authority, the appropriate authority, within whose jurisidction the office of the registering officer appointed under the Registration Act,1908 entitled to register any document of transfer in respect of such property is situated, shall be the appropriate authority to perform the functions of the appropriate authority in relation to such property.

By an agreement dated 29 September 1986, a property consisting of land and building located in village in Pune district was transferred to one M/s K by another private company M/s KT and documents were lodged for registration in the office of the sub-registrar at Bombay. Since the appropriate authority at Bombay held jurisdiction over the registering officer at Bombay who was entitled to register any document of transfer as per the Registration Act,1908, the transferor and the transferee filed Form 37 I on 13 October 1986 to the appropriate authority at Bombay. No action was taken on the form 37 I on the plea that the jurisdiction went with the situation of immovable property and since the property was situated outside the municipal limits of greater Bombay, no action was to be taken. It was however, noticed from item 10 of Form 37 I that the transferor and the transferee wanted the agreement to be registered at Bombay. The registering authority who registered the sale was the one within the jurisdiction of Bombay and the case fell within the jurisdiction of the appropriate authority at Bombay. In the circumstances the decision of the appropriate authority at Bombay not to take any action was not correct.

Procedure for fixation of reserve price and for auction.

2.01.15 After taking vacant possession,the properties are being guarded by security guards pending disposal and delivery of possession to the purchasers.Action for sale by auction is initiated through advertisements in two English and one local dailies fixing the date of inspection of the properties and the date of auction.

In January 1987, the Board communicated to the appropriate authorities that the reserve price should be the apparent consideration plus 15 per cent thereof. In September 1988, the Board reiterated this policy. In September 1990, the Board clarified that the limit of reserve price at 115 per cent of the apparent consideration was only the minimum limit and it was left to the discretion of the Chief Commissioners of Income-tax to fix the reserve price above 115 per cent of the

apparent consideration if they considered it a fit case.The employment of auctioneers on payment of commission was also allowed for the disposal of the immovable properties. Wherever reserve price was to be fixed below 115 per cent of the apparent consideration, Board's clearance was called for and the Board had emphasised that the very purpose and objective of acquiring properties under Chapter XXC would be defeated if they had to sell the properties at a rate lower than that visualized at the time of purchase. During the course of audit it was noticed that the reserve price for the disposal of the immovable properties was accordingly being fixed merely adding 15 per cent of the apparent consideration. The department thus did not rely on the fair value worked out by its Valuation Officer while fixing the reserve price though it was the basis on which purchase or otherwise was decided, nor did it take into account the element of price escalation when there was time gap in disposal of such properties.

In two cases in **West Bengal circle**,it was observed that the reserve price so fixed aggregating to Rs.29.35 lakhs during June/December 1989 fell short of the fair market value fixed by the valuation officers totalling Rs.34.31 lakhs and the properties were sold during February/June 1990 for a consideration of Rs.29.63 lakhs. It was further noticed that in none of the 4 auctions conducted till the date of audit, more than two bidders came forward. The successful bidders were 1 individual,1 trust and 2 private companies. One property whose reserve price was fixed at Rs.3.36 crores could not attract any bidder despite several attempts in the same circle.

In **Delhi circle** out of 38 cases, the successful bidders were private companies (11), Govt. and public sector units (11) individuals (15), and group of persons (1). In three cases, the properties could not be auctioned at the reserve price fixed by adding 15 per cent to the apparent consideration. The properties were sold after reducing the reserve price as per the

existing procedure followed by the department. In one case a property located on a part (500 sq.yards) of land with total area of 903 sq.yards, where apparent consideration was Rs.1.5 crores, was purchased by the Central Government on 28 April 1987. The valuation officer estimated its value in April 1987 at Rs.161.32 lakhs and the appropriate authority fixed the value at Rs.190 lakhs. The property was purchased by the Central Government at the discounted value of Rs.142.04 lakhs. However, the title deed was for the entire property, part of which was acquired and it could not be sold even after being auctioned 6 times. In October 1987 the Government stated that sale of a part of the plot amounted to sub-division and in the place (Connaught Place) and its proposed extension area, sub division of plot was not permitted. Consequently, for the last nearly 4 years from June 1987 to March 1991 Govt. money of Rs.1.42 crores was locked up. Similarly, in another case a sum of Rs.21 lakhs paid to purchase a property is blocked for 20 months as there was no bidder for the property, whose reserve price was fixed at Rs.24.15 lakhs, even after 5 auctions.

In **Maharashtra circle** out of 20 cases, in 16 there was only a single bidder to whom the property was sold. In one case the property was sold to the original tranferee who also happened to be the sole bidder in that auction.

2.01.16. Commenting on the earlier scheme of Acquisition of immovable properties by the Central Government, the Public Accounts Committee in their 211th Report (Seventh Lok Sabha) (1983-84) (Para 1.18 of the Audit Report on Direct Taxes 1981-82) presented to the Lok Sabha on 30 April 1984, observed that during the period 1979-83 in only a negligible number of cases the properties were acquired which led to the Government enhancing the ceiling limit for acquisition to Rs.1 lakh from 1 June 1984. The Committee had also recommended the adoption of random sampling method with a view to reduce the

workload and to eliminate avenues of all extraneous considerations.

In their 60th Report (Eighth Lok Sabha) (1986-87) laid on the table of both Houses of Parliament on 28 November 1986 regarding Action Taken on the recommendations of the Public Accounts Committee in their 211th Report, the Committee noticing that the department was not able to achieve the targets as per Action Plan 1984-85 and that the pendency had actually increased (Ministry's Action Taken Notes dated 13 November 1985) had, while reiterating their earlier recommendations regarding expeditious disposal of the pending cases by streamlining the processes involved and also considering the possibility of introducing a statutory time limit for their disposal, desired that the Government should assess the pendency as on the date of the deletion of the existing legislation and fix a time bound programme for the disposal of the cases expeditiously.

According to information furnished by the Ministry of Finance, the particulars of intimations in Form 37-G received from the registering authorities during the six years 1985-86 to 1990-91, the number in which notices were issued, the number in which action was pending as at the end of March 1991 were

STATEMENT `X'

Year	No.of intimations received	No.of notices issued	No.of notices dropped	No.of cases where orders were passed	No.of cases pending
1985-86	6,36,189	59,164	15,840	227	43,097
1986-87	2,43,871	61,823	54,170	87	7,566
1987-88	52,401	14,088	7,730	99	6,259
1988-89	21,617	15,356	13,620	70	1,666
1989-90	13,115	1,733	756	7	970
1990-91	5,537	998	214	-	784
Total	9,72,730	1,53,162	92,330	490	60,342

During the above period, only 92 properties had actually been taken over. The particulars of disposal of the properties acquired were not available.

The statistical data furnished by the Ministry of Finance indicated that the number of cases where action was initiated was small and out of this proceedings were dropped in a large number of cases. According to the departmental statistics the proceedings dropped were as high as 87 percent and 88 percent in the years 1986-87 and 1988-89 but was 26 percent, 55 percent, 44 percent and 21 percent in the years 1985-86, 1987-88, 1989-90 and 1990-91 respectively. In contrast, the number of cases where acquisition orders were passed was negligible. The number of properties acquired was 92 during 1985-86 to 1990-91. However, the acquisition authorities were guided by the instructions issued by the Board for summary disposal of the proceedings in cases where the apparent consideration did not exceed rupees five lakhs from 1 April 1986 and rupees ten lakhs from 11 August 1988.

Lack of Co-ordination with other authorities

2.01.17 Under the provisions relating to acquisition of properties as existing upto 30 September 1986, the registering authority was required to furnish a fortnightly statement to the competent authority listing out the cases of transfer on sale/mortgage for apparent consideration exceeding Rs.50,000/Rs.1 lakh, along with copies of the instruments. This provision stands deleted from the Income-tax Act from 1 October 1986 and there is no similar provision in the Registration Act. Consequently, as at present, there is no liaison between the Income tax authorities and the State Registration authorities except that the registering officer shall not register any document of transfer of immovable property (a) without a no objection certificate from the appropriate authority if the value of the property exceeds Rs.10 lakhs and (b) without tax clearance certificate from the Income-tax department in favour of the transferor if the value exceeds Rs.2 lakhs. There is, thus, no cross-check with the cases being registered.

There is also no information with the Department in regard to the fair value, as distinct from the declared/apparent value, of the property as may have been adopted by the Registering authority for the purpose of computation of duty/fee.

(a) Registration of cases without no objection certificate from the Income-tax department.

In **Kerala circle**, in 3 cases of transfers, one to a private party and two to government departments, where the apparent consideration exceeded Rs.10 lakhs each, the transfer deeds were registered without obtaining the no objection certificates from the appropriate authority. It is, however, not known whether in these cases Forms 37 I were filed. 8 such cases were also found registered in **Calcutta circle.** In **Karnataka circle**, nine cases of transfer of immovable properties between February 1988 and January 1990 came to notice of Audit where the fair market value of the properties for stamp duty purposes, as determined by the Registration Authority of the State Government, was in excess of Rs.10.00 lakhs while the sale consideration shown in the agreement to sale was less than Rs.10.00 lakhs.

(b) Co-ordination with reference to State Land Ceiling Acts.

Tamil Nadu circle

When the landed property of a person is hit by the Tamil Nadu Land (Ceiling and Regulation) Act,1978, and the excess land is acquired by the Government, the owner is paid a compensation based on the zonal value determined under the Act, which is lower than the market value of the property. As provisions of Chapter XXC will prevail over provisions of Tamil Nadu Land Ceiling Act if a property is purchased by the appropriate authority, the value mentioned as apparent consideration would be payable to the transferor and not the compensation under the Land Ceiling Act which would normally be lower.

During the year 1986-87, the department had purchased eight properties without obtaining clearance from the Tamil Nadu Urban Land Ceiling authorites and paid the apparent consideration specified in the agreements. In one case, the department had purchased a property for an apparent consideration of Rs.1.40 crores and sold the same for Rs.2.60 crores in public auction. Subsequently it was pointed out by the Commissioner and Secretary to the Government of Tamil Nadu that the State Government had ordered acquisition of excess land measuring 686 sq.mt. in the above property and remarked as under:

"For excess land coming under the purview of Tamil Nadu Urban and Land (Ceiling and Regulation) Act,1978, the Income-tax department pays a huge price as against zonal value determined under Tamil Nadu Land (Ceiling and Regulation)Act, thereby incurring loss to Central Government".

Thereafter a copy of the order by the appropriate authority for the purchase of immovable property was being forwarded to the concerned registering authority also with a request to specify whether the property purchased was hit by the Urban Land Ceiling Act. It was mentiond therein that in case no communication in this regard was received from the Urban Land Ceiling authorities within 15 days of service of the letter enclosing the order issued, it would be considered that the property was not hit by Tamil Nadu Urban Land Ceiling Act.The Urban Land Ceiling authorities were contesting that it would take a month for them to send a report as original documents, that too in different sections, were to be verified in each case.In one case, the report was received after 9 months of issue of purchase order. This matter has not been sorted out and as the payment towards apparent consideration would require to be made before the end of subsequent month of issue of purchase order under section 269 UD, the Income-tax department was going ahead as per the presumption embodied in the letter to the Urban Land Ceiling authorities and in a number of cases final payment of apparent

consideration was made without obtaining formal clerance.

Karnataka circle

(i) Almost in all the cases of transfer of immovable properties that came up to the appropriate authority, Bangalore, clearance of the Urban Land Ceiling Authority was not obtained for their transfer.In a considerable number of cases the appropriate authority rejected the statements on the ground that these were nonest in law, premature, defective and invalid, but in cases where it chose to intervene, the appropriate authority had endorsed a copy of its purchase order to the State Government with a request to intimate whether the property was hit by the Urban Land Ceiling Act. Clearance from Urban Land Ceiling Authority is still awaited in 12 cases of transfers involving a payment of Rs.636.97 lakhs.

(ii) In one case where the Central Government had purchased the property by paying the apparent consideration of Rs.108.47 lakhs on 29 June 1990(IV floor in a building having four floors), the State Government informed the authority on 5 September 1990 that the property was hit by the Urban Land Ceiling Act,1976 and the maximum compensation payable for the portion of the property purchased by the Government was just Rs.50,000 as against Rs.108.47 lakhs paid by the Government to the transferor.

Uttar Pradesh circle

Under the Urban Land Ceiling Act, vacant sites or immovable properties having surplus land cannot be transferred except with the prior approval of the authority constituted under the Act. In the absence of liaison with the State government authorities the appropriate authority has to take into account the risk element in deciding the adequecy or the reasonableness of the apparent consideration for making pre-emptive purchases.

In one case, free hold land measuring 4

bighas 14 biswas and 15 biswansi with pucca double-storeyed farm house was agreed to be sold for Rs.15.37 lakhs. On receipt of Form 37-I, the Valuation Officer, on reference to him, estimated the fair market value at Rs.21.14 lakhs. The appropriate authority passed an order for purchase of the property, but clearance was not obtained from the land ceiling authorities. Subsequently, a communication was received from the land ceiling authorities that since no evidence of agricultural operations being carried on was produced, the competent authority was considering action under Section 8(4) of the said Act and therefore till final decision, the appropriate authority was requested not to allow transfer of the said land. The case is now sub-judice. The transferee filed writ petition against the order of the appropriate authority and obtained stay order. The transferor moved application for vacation of the stay order.

Lack of coordination with other wings of the Income tax Department

2.01.18. Test audit revealed that there was hardly any co-ordination and mutual exchange of information between the various functionaries of the Income tax department,the registering officer and the appropriate authority. The appropriate authority did not also pass on copies of his orders on the valuation reports estimating the market values of properties under consideration for purchase to the assessing officers. The officers issuing tax clearance certificates likewise did not send copies thereof to the appropriate authority.

Madhya Pradesh circle

A private limited company at Bombay executed an agreement on 19 April 1988 for sale of 1,30,680 sq.ft. of land at Rs.15.30 per sq.ft, with superstructure built thereon. Out of the total consideration of Rs.20 lakhs, the sum of Rs.19 lakhs was paid and physical possession of the land handed over to the transferee on the date of agreement on leave and licence basis at Rs.1500 per month, being the interest on the balance of Rs.1 lakh to be paid at the time of registration. Form 37 I was filed on 30 June 1989. It is not known

whether the appropriate authority passed on this information to the assessing officer at Bombay.

In another case, the owners of a land and structure (70361 sq.ft)entered into an agreement on 14 August 1986 for an apparent consideration of Rs.55 lakhs, out of which Rs.53.35 lakhs was paid by post-dated cheques (17 February 1986 and 30 June 1987) which were handed over on the date of the agreement and the balance was paid as brokerage to the brokers. On the basis of Form 37 I filed on 5 July 1989 by the transferors, the valuation officer certified on 31 July 1989 that value of the property had been grossly understated. The particulars of PAN/Assessment ward were not available in Form 37 I and no co-relation was possible to verify the action taken by assessing officers.

In a third case, the co-owners entered into an agreement on 13 September 1986 for sale of 1 lakh sq.ft. of land for a total consideration of Rs.114 lakhs including Rs.8 lakhs to be paid to get the tenants evicted. According to the agreement, Rs.71 lakhs was to be paid at the time of the agreement and of handing over possession. Form 37 I was filed on 5 July 1989 but it did not contain the PAN/assessing ward, etc., and so no cross-verification was possible.

In yet another case, a theosophid society entered into an agreement on 28 March 1985 for sale of 50,000 sq.ft. of land for an apparent consideration of Rs.45.51 lakhs (Rs.3.50 lakhs advance paid) and possession was handed over to a construction firm in September 1985. Form 37 I was submitted on 3 August 1989, but as per sale instance of July 1985 the selling rate prevailing in the same locality was Rs.200 per sq.ft. The fair market value of the property would not have been less than a crore of rupees and the value shown in the Form 37 I was grossly understated. It is not known whether this information was passed on to the concerned assessing officers for appropriate action.

Delhi circle

Out of 28 cases test checked, in 13 cases there was no exchange of information between the appropriate authority and the assessing officers where the transferors and tranferees are assessed.Out of the other 15 cases where purchase orders were found, 13 cases where payments were made to the transferors were referred to the concerned assessing officers to intimate outstanding tax liability.

West Bengal circle

A review of the assessment records of nine transferors belonging to high income group or large industrial houses revealed that in five cases the assessees had not disclosed information about the sale of properties or the gains arising therefrom and the assessing officer also had made no enquiries. In the four other cases where the gains were disclosed, no details were filed by the assessees nor called for by the department. On a correlation with the market values determined by the valuation cell, it was noticed that there was escpaement of gift tax of Rs.8.69 lakhs in two cases and income-tax of Rs.12.75 lakhs in one case.

Effect of lack of co-ordination on tax liability

2.01.19. Under the Income-tax Act,1961, with effect from assessment year 1964-65, where a capital asset is transferred to a person who was directly or indirectly connected with the assessee and the Income-tax Officer had reason to believe that the transfer was effected with the object of avoidance or reduction of income-tax liability to capital gains, the full value of the consideration for the transfer must be taken to be the fair market value of the capital assets on the date of transfer. Further, if in the opinion the Income-tax officer the fair market value of a capital asset transferred by an assessee as on the date of the transfer exceeded the full value of the consideration declared by the assessee in the instrument of transfer by 15 per cent or more of the value so declared, the full value of the consideration for such capital asset will be taken to be its fair market value on the date of transfer.

In terms of the provisions of the Gift-tax Act, where property is transferred otherwise than for adequate consideration,the amount by which the market value of the property on the date of transfer exceeded the value of the consideration shall be treated as gift made by the transferor.

In July 1976 and September 1980, the Central Board of Direct Taxes had clarified that where the provisions regarding under-statement in transfer of immovable properties for income-tax were invoked,proceedings should also be initiated for purposes of the gift-tax.In September 1981,the Supreme Court held that only either of these provisions would be applicable and that the provisions of tax liability on account of capital gains could not be invoked without discharging the burden of proving that the actual consideration received was more than what was declared. In this context, the provisions relating to capital gains were deleted from 1 April 1988. In March 1985,after four years of the Supreme Court judgement, the Central Board of Direct Taxes also clarified that in respect of bona fide transactions for inadequate consideration, the provisions of the gift-tax would be attracted and transactions where there was understatement of actual consideration, the provisions of capital gains would be applied.

Earlier in May 1984, the Board had instructed that proceedings for gift-tax might be initiated alongwith the proceedings for acquisition against the transferor. It was further clarified that even in cases where the competent authority had initiated or proposed to initiate action for acquisition of properties, intimations regarding the proceedings should be communicated to the Gift-tax Officers having jurisdiction over the transferors, with a note to that effect in the acquisition file. In November 1985, the Board on the advice of the Ministry of Law, instructed that the proceedings for acquisition and gift-tax were mutually exclusive and only in case of dispute action would be initiated on protective basis. However, gift-tax proceedings might be

initiated in cases where the market value was higher than the consideration that actually passed hands.

In view of the provisions explained above, it is imperative in the interest of revenue that the respective assessing authorities have access to and/or are kept advised of fair market value in respect of properties so that proceedings for levy of capital gains tax/gift tax/wealth tax may be initiated, as warranted. However, it was seen in audit that there was no operative system of liaison between the assessing authorities on the one hand and the appropriate authorities/State registration authorities/competent autho rities on the other. Consequently even in respect of cases where the latter authorities had determined the fair market values at substantially higher levels than the apparent consideration, proceedings for levy of capital gains/gifts etc. tax were not initiated. The position in respect of 749 cases noticed in audit is as below:

Sr.No.	Circle	No.of cases	Apparent considera-tion	Fair market value	Difference (In lakhs of rupees)
01.	Tamil Nadu	48	768.11	1,117.96	349.85
02.	Delhi	97	1,430.15	2,066.65	636.50
03.	Madhya Pradesh	335	584.26	1,503.26	919.00
04.	Karnataka	27	116.17	170.11	53.94
05.	Uttar Pradesh	103	627.34	1077.56	450.22
06.	Rajasthan	86	291.52	550.12	258.60
07.	Bihar	5	39.44	64.06	24.62
08.	Andhra Pradesh	48	101.53	138.77	37.24
		749	3,958.52	6,688.49	2,729.97

Maintenance of Register

2.01.20. The scheme for pre-emptive purchase was introduced since 1 October 1986. Though more than 4 years have elapsed, the Central Board of Direct Taxes has not yet laid down any procedure, prescribing the maintenance of registers/records for watching receipt and disposal of statements in Form 37-I, and for keeping track of further action/developments in respect of properties for which purchase orders are issued including the date (s) of serving of notice to the transferors/transferees/persons in occupation of the premises, payment(s) to be made and ensuring physical takeover of the property within the prescribed time limit etc., details of cases pending in the court for their effective pursuance, details of properties that need to be put to auction, maintenance expenditure thereagainst, numbers and names of bidders in each auction etc. In the absence of standardised procedure, the records as available in different circles are not complete nor uniform. On test check, it was found in Maharashtra, West Bengal and Delhi circles that while certain registers have been devised and are being maintained, they have gaps and complete information about progress of cases in hand is not available.

2.02 SCHEME OF INVESTMENT ALLOWANCE/INVESTMENT DEPOSIT ACCOUNT

Introductory

2.02.1 The imperatives of economic development lie in sustained growth in industrial and agricultural production. Industrialisation is thus vital to economic progress. Industrial production made rapid strides in terms of variety and quality, through policies practised in terms of the Industrial Policy Resolutions of 1948, 1956 and 1980 including a number of incentives provided to industries from time to time.

The Scheme

2.02.2 The successive Plan objectives, **inter alia**, envisaged optimum utilisation of installed capacity and modernisation and expansion of industries so as to maximise production, achieve higher productivity and increase employment potential. In pursuance of these objectives, the fiscal policy as reflected in the annual budgets of the

Central Government spells out the incentives and concessions conferred in the levy of direct and indirect taxes. One of the earliest incentives for the acceleration of industrialisation and to generate enough capital internally for modernisation of plant and machinery was introduced in the income-tax law in the year 1955-56. Development rebate, as it was then named, was in the statute book for nearly 2 decades, till it was replaced in 1976 by investment allowance in an amended form. This allowance continued upto the assessment year 1990-91 except for the assessment year 1988-89. An alternative, called investment deposit, was inserted from assessment year 1987-88 for profit making companies, if they chose to avail of the concession. This was also applicable upto the assessment year 1990-91. These allowances were in addition to the normal depreciation allowed under law, and were granted on consideration of the high cost of acquisition of capital assets, of the possible wear and tear which these assets suffer in the course of business and the need to generate adequate funds internally for eventual rehabilitation of these assets.

Magnitude of the allowance

2.02.3 According to statistics compiled by the Directorate of Income-tax(Research, Statistics, Publication and Public Relations) (All India Income-tax Statistics-Assessment year 1987-88), the deduction for the year allowed in 6855 cases in respect of investment allowance aggregated to Rs.276.88 crores involving a tax relief of Rs.134.97 crores, against the estimated tax revenue of Rs.5610.61 crores from business or profession. This was in addition to the depreciation allowance of Rs.345.07 crores involving tax relief of Rs.110.36 crores. The relief in respect of investment allowance to the total reliefs and deductions under Chapter VIA aggregating to Rs.1017.85 crores worked out to 27.5 per cent, involving a substantial forgo of revenue to the exchequer. Bulk of these were allowed in Maharashtra (180.64 crores),Gujarat(Rs.26 crores) West Bengal (Rs.13.01 crores), Tamil Nadu (Rs.15.51 crores) and UT (Delhi)(13.09

crores). Industrywise figures are not available.

Objectives

2.02.4 The twin objectives of the scheme of investment allowance were:

(i) to provide funds internally to meet investment costs,

(ii) to subsidise the cost of replacement of equipments and to compensate for its inflation.

Evolution and historical develop-ment

2.02.5 On the recommendations of Taxation Enquiry Commission (1953-54) for an incentive towards investments in capital assets, being plant and machinery, development rebate was introduced from the year 1955-56. This was allowed in the computation of business income by way of a deduction equal to 25 percent of the cost of the investment subject to creation of a specific reserve.Theoretically, the allowance was intended to compensate, to some extent, for inflation and increased cost of replacement of plant and machinery as an alternative to allowing depreciation on the current cost which required revaluation from time to time. This concession was generally withdrawn in respects of assets installed after 31 May 1974 on the ground that it had played its role and no more concession was needed. Taking note of the sharp increase in capital costs in subsequent years and the growing need to provide the necessary stimulus for growth and modernisation, especially of the corporate sector for renewals and replacements, an investment allowance, identical to development rebate was introduced from 1 April 1976. In both these cases, the use of the tax free reserves was restricted to purposes conducive to industrial growth. Later, a funding scheme was also introduced from the assessment year 1987-88 as an alternative to investment allowance so as to discourage well-established concerns to lean on public financial institutions for financial support without waiting for profits from fresh investment.

Law and Procedure

2.02.6 The law and procedure regarding the schemes of investment allowance and investment deposit are contained in Section 32A,32AB,43A,155(4A) of the Income-tax Act,1961 and Rules 5A,5AA,5AB of the Income-tax Rules,1962.

Investment allowance was generally admissible in respect of new ship or air-craft acquired after 31 March 1976, and also in respect of new machinery or plant installed after that date in certain business. No investment allowance was allowed in respect of assets not engaged in production or manufacture or those fully amortised during one year. Certain second hand assets and machinery or plant installed in the business of repairs to ocean-going vessels or other powered aircraft were also eligible to the allowance.It was allowed in the year of installation or if put to use in the immediately succeeding previous year, then in that year. The admissible amount was equal to 25 per cent of the actual cost borne by the assessee (35 per cent in certain cases). As the investment allowance was intended to provide funds for replacement or acquiring modern machinery or plant, the law required the creation of a reserve to be utilised for the acquisition of new machinery or plant during a period of 10 years and until then, for business advancement of the undertaking. A lock-in period of 8 years was prescribed for legal possession of the relevant assets and the same period was prescribed for carry forward of any unabsorbed investment allowance owing to nil or insufficient profits.

The conditions attached to the allowance can be grouped under certain broad categories, viz., eligibilty conditions and statutory requirements, ineligible assets,consequences of breach of conditions, computation of cost, carry forward and set off of deficiencies and other areas.

The investment deposit deduction was allowed upto 20 per cent of the profits of eligible business, that is,profits of industrial undertakings other than Industrial undertakings not being small scale industrial

units, carrying on the business of construction,manufacture or production of any article or thing as specified and the business of leasing or hiring of machinery or plant to an industrial undertaking referred to above, to the extent of the amount deposited with the Development Bank within six months from the end of the previous year, or utilised for the purchase of new assets.

Highlights

2.02.7(I) To promote modernisation and expansion of industries, a deduction for investment allowance was allowed on new machinery or plant installed in the business of manufacture or production of any article in the case of small scale industrial undertakings and of priority articles by other undertakings.

The scheme aimed at generation of funds internally, thereby reducing dependence on borrowings. While sick undertakings or those incurring losses could not avail the benefits, other undertakings also remained largely dependent on borrowings, having regard to their investment needs and the quantum of benefits available.

(2) The conditions attached to the grant of investment allowance required verification of certain particulars such as whether the asset acquired was new or second hand, the dates of its installation and first use, the fact of creation of a reserve to the prescribed extent, retention of the asset for the prescribed period, etc. The Act, however, merely provided for furnishing of the particulars of the rate and amount of investment allowance claimed and the investment allowance allowed on existing assets in earlier years. Thus,most of the relevant particulars had to be called for. Test-review revealed that in many cases even the prescribed particulars were not being furnished. The Income-tax Act was amended from 1 April 1989 providing for assessment in a summary manner of bulk of the cases subject to prescribed adjustments, one such area being the determination of the prima facie, admissibility of the investment allowance with reference to the return, accounts and

accompanying documents. However, under the procedure of summary assessment any reference to the assessee is barred.Though the form in which the particulars regarding investment allowance were furnished did not provide for some of the vital details relevant to the entitlement and retention of the allowance, revison of the prescribed form was not considered.

(3) Investment allowance was admissible on machinery or plant installed in an industrial undertaking for the purposes of construction, manufacture or production of any article or thing as specified. The terms `Industrial undertaking', `construction,manufacture or production' and `article or thing' have not been defined under the Act. This led to a number of cases involving litigation and also arguable audit findings/departmental views covering interpretation of the provisions. Following the recommendation of the Public Accounts Committee in their 136th Report 1987-88 (Eighth Lok Sabha), the Government defined the term `industrial undertaking' for the purpose of Section 10(15)(iv)(c) regarding exemption of interest payable on certain foreign borrowings; but a common code of definitions has not yet been introduced.

(4) Investment allowance was not admissible unless the assets were owned and wholly used in the business of manufacture or production of articles. Nevertheless, investment allowance was being allowed on assets hired to others or acquired under hire purchase agreements.

(5) Investment allowance is to be calculated on the actual cost of the asset which does not include that portion of the cost which has been met directly or indirectly by any other person or authority. In 1976, the Board clarified that the amount of subsidy received under the 10 per cent Central Outright Grant of Subsidy Scheme, 1971' for industrial units would be deducted in computing the cost of assets for purposes of development rebate. Karnataka, Andhra Pradesh, Madhya Pradesh,

Gujarat and Kerala High Courts[1] have, however, held that though the subsidy is quantified at a percentage of the fixed capital asset, the Central subsidy scheme did not treat the subsidy as granted for the specific purpose of meeting a portion of the cost of the asset and it is granted more as a recompense for the hardship and inconveniences caused to the entrepreneur. On the other hand the Punjab High Court[2] had taken the view that the subsidy is deductible in the computation of actual cost. Though the law was thus fluid, the Govt. did not amend it to expound clearly the intention behind the legislation, leading to avoidable litigations and audit observations.

(6) Where in consequence of a change in the rate of exchange of currency, there was variation in the assessees' liability on account of an imported capital asset, the actual cost has to be adjusted to the extent of the variation in the year of fluctuation of rate of currency.This provision, it is laid down, was not to be taken into account for the purposes of the deduction on account of development rebate. Madras and Bombay High Courts[3] had held that this provision did not apply in calculating the deduction, whereas Calcutta, Madras (Division Branch), Gujarat and Andhra Pradesh High Courts[4] had held that there was no bar to considering the increase or decrease in the value of the asset on account of devaluation of currency in computing the cost of the asset for the purpose of development rebate. Despite the conflicting opinions of courts, there was no attempt to set right the controversy. Meanwhile, cases had been noticed in audit where the prescribed adjustment was carried out.

(7) In course of the test-review, many mistakes were noticed in regard to the

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1. 172-ITR 655, 168-ITR-632, 175-ITR-22, 181-ITR-90
2. C.I.T. Vs. Jindal Bros. Rice Mills - (1988\9) 179-ITR-470 (P&H)
3. 159-ITR-12, 116-ITR-819
4. 130-ITR-351, 109-ITR-646, 112-ITR-64, 156-ITR-283, 133-ITR-382

conditions of eligibility, statutory requirements, excepted items, breach of condition, computation of cost, and carry forward and set off of unabsorbed allowance, etc. The total effect of the mistakes reported in the review exceeds Rs.124 crores.

Scope of the review

2.02.8 This review attempts an evaluation in general of whether the objectives set forth in the legislation for capital formation and promotion of industrialisation were monitored and evaluated and corrective action taken by the Income-tax department. It also makes an assessment of the degree of compliance of law and procedural requirements and the manner of implementation of the scheme by the Income-tax department. In so doing, errors, omissions in the application of the law and rules and other procedural lapses noticed have been highlighted in the Report.

Detailed review

2.02.9 The review was conducted in representative cases in certain selected sectors, viz. Engineering, Pharmaceuticals, Chemicals and Plastics, Tea, Sugar, Automobiles, Textiles, Shipping, Construction contracts, Hotels, etc., for the assessment years 1975-76 to 1988-89. The results are summaried in the following paragraphs:

Statisti-cal data

2.02.10 A study of companies from 13 selected industries, both in public and private sectors, in various States revealed that the Government had sacrificed revenue of Rs.403.89 crores by way of grant of investment allowance aggregating to over Rs.740.59 crores in these cases. Details of the investment allowance allowed, revenue foregone, reserve created, fixed capital added during the period 1976-77 to 1989-90 by way of replacement, increased capacity or new activity, and new assets acquired, Statewise and industry wise are as per Annexures A & **B.**

Success of the Scheme

2.02.11 The main objective of the scheme was to stimulate further expansion of capacity and to ease the strain on existing undertakings in replacing worn out and obsolete machinery or plant and to provide the corporate sector with adequate funds for

renewals and renovation so as to make it less dependent on public financial institutions for resources. Available details indicate that against new assets costing over Rs.6374.77 crores acquired over the period 1976-77 to 1989-90, the available resources in the total reserve created under the concessional dispensation came to around Rs.554 crores, and about Rs.404 crores were revenue foregone. Thus while the concessions embodied in the scheme certainly provided some assistance to industry, dependence for acquisition of capital assets on other sources of fund like borrowings remained heavy. Besides, sick units or othersincurring losses could not take advantage of the concessions.

Conditions of eligibility

2.02.12 The entitlement to investment allowance was dependant on:

(a) The assessee,whether an industrial undertaking and the business,whether specified,

(b) Ownership,

(c) Extent of use in business, wholly or mainly, and

(d) Year of use

(1) Consistent with the policy of promotion of power sector, of small scale industries and of other priority and export-oriented industries, the investment allowance was admissible in respect of new machinery or plant installed after 31 March 1976 in the following cases:

(i) for the purposes of business of generation or distribution of electricity or any other form of power,

(ii) in a small scale industrial undertaking for the purposes of business of manufacture or production of any article or thing,or

(iii) in any other industrial undertaking for the purposes of business of construction,

manufacture or production of any artcle or thing not specifically excluded, being non-priority items referred to in the Eleventh Schedule.

(iv) Investment allowance was also admissible in respect of new ship or aircraft acquired after 31 March 1976 in the business of operation of ships or aircraft, any new machinery or plant installed between 1 April 1983 and 31 March 1987 in the business of repairs to ocean going vessels as approved by Central Govt., and also in respect of second hand assets imported from abroad under certain conditions.

(2) Test-check in audit revealed that in 106 cases investment allowance of Rs.5024.62 lakhs was allowed on prohibited items such as those mentioned in the Eleventh Schedule, on assets used in civil construction works, not being small scale industrial undertakings and on assets engaged in business not involving any manufacture or production etc., involving undercharge of tax of Rs.2796.48 lakhs.

(i) It has been judicially[5] held that the term `Industrial company' covers a construction company only when it is engaged in the construction of ships. Companies engaged wholly or mainly in the construction of anything other than ships cannot therefore be considered as industrial companies and no investment allowance would be admissible in respect of machinery or plant installed and used by such companies. Further, in the case of a small scale industrial undertaking, investment allowance was admissible in respect of machinery or plant installed and used in the business of manufacture or production of any article or thing, but not in the business of construction.

In Assam, Bihar and West Bengal circles, 3 companies were allowed investment allowance aggregating to Rs.25.16 lakhs involving short charge of tax of Rs.14.70 lakhs in assessment years 1983-84 to 1987-88, though the companies were engaged in the construction of

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5. 126-ITR-377 (Bombay), C.I.T. Vs. N.U.C. Pvt. Ltd.

buildings and roads and in executing civil contract work like earth excavation and bed lining work.In Madhya Pradesh circle, 6 small scale industrial undertakings engaged in construction business were allowed a total investment allowance of Rs.26.65 lakhs in assessment years 1987-88 to 1989-90 which led to short levy of tax of Rs.8.09 lakhs.

(ii) According to the judiciary[6], hotel is mainly a trading concern and the Central Board of Direct Taxes had clarified in January 1986 that no investment allowance was admissible in the case of assessees operating hotels as they were not industrial undertakings.

In Maharashtra, Rajasthan, Haryana (UT), Uttar Pradesh and Tamil Nadu circles, for the assessment years 1981-82,1982-83,1984-85,1986-87, 1987-88 and 1989-90, in the case of 6 companies and one registered firm engaged in the hotel business, investment allowance of Rs.47.44 lakhs was allowed leading to short levy of tax of Rs 30.04 lakhs.

(iii) No investment allowance was admissible unless the machinery or plant were installed and used for the purpose of business of manufacture or production of any article or thing.According to the Supreme Court[7], the broad test for determining whether a process involved manufacture is to find out whether it brings out a transformation of old components so as to result in a commercially different article or commodity.

In Tamil Nadu, Maharashtra, Madhya Pradesh, Andhra Pradesh, Gujarat, West Bengal,Punjab, Karnataka and Uttar Pradesh circles, 65 companies engaged in various business viz., the medical profession and in the business of milk products, mining, quarrying of granite stones, exihibition of cinema films, bulk storage for refrigeration, air conditioning of premises, etc., converting skull lumps

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6. 91-ITR-289
7. 155-ITR-799-800

into small pieces, drilling tube wells, multi-colour printing of glass bottles, processing of seeds to render them fit for germination and keep them free of weeds involving the activity of storage and preservation, blending and packaging of tea (processing), manufacturing tools (automatic and semi-automatic), jigs, dyes and tools, of photo composing and type-setting, investment business, business of production of things like electric installations, expenditure on technical know-how, weigh bridges, testing tools, laboratory equipments, tube wells, etc., were allowed an aggregate investment allowance of Rs.3623.41 lakhs involving short assessment of tax of Rs.1945.11 lakhs in assessments years 1979-80 to 1988-89.

In Karnataka circle, an individual and a firm running poultry and stud farms were allowed investment allowance of Rs.8.73 lakhs involving tax effect of Rs.4.57 lakhs.

(iv) In the case of industrial undertakings which are not small scale industrial undertakings, investment allowance was not admissible if the article or thing produced was listed in the Eleventh Schedule to the Income-tax Act for the relevant years.

In Maharashtra, Madhya Pradesh, Uttar Pradesh, West Bengal, Delhi and Andhra Pradesh circles, 18 big companies including a multinational electronic company, were allowed a total investment allowance of Rs.1,277.39 lakhs during assessment years 1977-78 to 1989-90 resulting in aggregate undercharge of tax of Rs.765.15 lakhs. These companies were engaged in the manufacture of pigments, colours, paints, enamels, varnishes, black and cellulose lacquers (item 26), of concrete pipes, steel pipes, septic tank, pen stock sleeper, etc(item 16), soft-drinks using synthetic essences and table sanitary wares (item 16), aerated and other mineral water, syrups, beverages etc. (item 11), of tape-recorder, radios, record players, electric bulbs and tubes and public address system (items 7,8,12,29) on which no investment allowance was admissible unless the industrial undertakings producing these

goods were small scale units. The units covered were not small scale.

(v) In Uttar Pradesh circle, in the case of 4 companies, investment allowance was admitted for the assessment year 1989-90 without ascertaining the date of acquisition/installation of the machinery or plant, although investment allowance was admissible for assessment year 1989-90 only in respect of assets which were installed during financial year 1987-88 and contracts for the purchase of which were entered into before 12 June 1986. The irregular allowance led to short levy of tax aggregating to Rs.19.87 lakhs. In another such case, investment allowance of Rs.2.71 lakhs involving revenue effect of Rs.1.42 lakhs was allowed for the assesment year 1989-90 though the machinery/plant was acquired after 31 March 1988.

(vi) In Andhra Pradesh circle, in the assessment for the assessment year 1977-78 (year ended June 1976) concluded in July 1980, an assessee company was allowed deduction of Rs.23.41 lakhs towards investment allowance. This included an amount of Rs.13.03 lakhs which was related to machinery installed during the period ended June 1975, and therefore, did not qualify for the deduction. The incorrect grant of relief resulted in potential short levy of tax of Rs.7.53 lakhs.

(3) No investment allowance was admissble unless the machinery or plant was legally owned by the assessee. Cases were noticed during test-check where investment allowance was allowed on machinery or plant which were purchased on hire purchase basis or were leased out to other parties. Under a hire purchase agreement, possession of the asset is delivered to the lessee only on completion of purchase in the manner provided in the agreement. In the interregnum the hirer is not treated as the owner of the asset and so no investment allowance was admissible.

(i) In Maharashtra Circle, three companies were allowed a total investment allowance of

Rs.52.68 lakhs in assessment years 1987-88 and 1989-90 involving revenue effect of Rs.27.84 lakhs though the machineries were given out on lease/hire basis.

(ii) (a) In West Bengal Circle in the assessment of a public limited company, for the assessment years 1986-87 and 1987-88 completed by the Assistant Commissioner of Income-tax in February 1989 and February 1990, investment allowance of Rs.32.54 lakhs and Rs.41.84 lakhs respectively was erroneously allowed to the assessee though under the agreement of 27 July 1984 the entire spinning mill including the plant and machinery and other assets were leased out to another company against receipt of monthly licence fee and under supplementary agreement of January 1986 it was agreed that additional licence fee would be paid for installation of new plant and machinery by the assessee. Audit scrutiny revealed that investment allowance to the extent of Rs.19.74 lakhs and Rs.38.61 lakhs were adjusted against the profit for the assessment years 1986-87 and 1987-88 respectively and the balance unabsorbed investment allowance of Rs.16.03 lakhs was allowed to be carried forward to assessment year 1988-89. The mistake resulted in under assessment of income of Rs.58.35 lakhs in aggregate involving short levy of tax of Rs.29.67 lakhs for the assessment years 1986-87 and 1987-88. In addition, carry forward of unabsorbed investment allowance of Rs.16.03 lakhs to assessment years 1988-89 resulted in potential tax effect of Rs.8.02 lakhs.

(b) A private limited company let out on hire the entire plant and machinery and the factory building with all movable and immovable assets to another company with effect from 1 August 1983. The assessment of the `owner' company for the assessment years 1981-82, 1982-83, 1983-84 were completed/revised between January 1984 and March 1988 determining loss at Rs.27,307, Rs.61,017 and Rs.82,736 after allowing in the assessment investment allowance of Rs.1.57 lakhs, Rs.33,268 and Rs.3.11 lakhs respectively. Since the assessee company had

transferred the plant and machinery as a whole against `hire charges' to another company, no investment allowance was allowable in the assessment completed after the execution of the contract in August 1983. The mistake in granting investment allowance resulted in a net under assessment of income of Rs.4.19 lakhs involving non-levy of tax of Rs.4.53 lakhs (including interest).

(4) Investment allowance was also not admissible if the machinery or plant were not put to use. It has been judicially held that plant and machinery must be used for the purpose of enabling the owner to carry on business and earn profit. It cannot be held that the machinery has been used for the purpose of business unless commercial production has started.

In Uttar Pradesh Circle, in the case of a company investment allowance of Rs.48.16 lakhs was allowed on the entire `capital works in progress'in assessment year 1987-88 although no such allowance was admissible if it did not relate to cost of plant and machinery actually installed and put to use for production during the relevant previous year. The irregular allowance led to incorrect carry foward and resultant potential tax effect of Rs.24.08 lakhs.

(5) Investment allowance was normally allowed as a deduction in the previous year in which the machinery or plant was installed. However, if such assets were first put to use in the very next year, then it was to be allowed in that year only. In other words, investment allowance was denied beyond the second year unless put to use within that period.

(i) In the assessments of a company in West Bengal for the assessment years 1983-84 and 1984-85, investment allowances of Rs.41.48 lakhs and Rs.72.28 lakhs were allowed in February 1986 and in March 1986, though plant and machinery purchased during the relevant previous years at the cost of Rs.1.66 crores and Rs.2.89 crores respectively were not brought to use.As a result there was excess

grant of investment allowance to the extent of Rs.113.76 lakhs with consequent under-charge of tax of Rs.65.12 lakhs in the two assessment years.

(ii) In Tamil Nadu, an assesee company proposed to put up an integrated plant for production of different types of magnetic tapes at a total cost of Rs.9.25 crores. The project was proposed to be implemented in a period of two years. During the previous year relevant to the assessment year 1986-87 the company acquired machinery costing Rs.80.54 lakhs on which investment allowance of Rs.20.13 lakhs was allowed. The machinery purchased was not put to use in the previous year relevant to the assessment year 1986-87 as the plant itself was still under execution. The incorrect allowance resulted in short levy of tax of Rs.10.57 lakhs (Potential).

(iii) In the case of 10 assessees in Madhya Pradesh for the assessment years 1980-81 to 1988-89, investment allowance of Rs.477.74 lakhs was allowed on assets (plant and machinery) purchased, though the plant and machinery were not installed and put to use for the purpose of the business during the relevant previous year in which the investment allowance was claimed. The tax effect on account of non-fulfilment of this essential condition was Rs.247.70 lakhs.

(iv) In Andhra Pradesh in the assessment concluded in November 1980 for the assessment year 1980-81 (year ending June 1979), an assessee's claim for deduction towards investment allowance amounting to Rs.77.40 lakhs on the basis of additions to machineries costing Rs.309.62 lakhs was accepted and benefit of carry forward of the deduction was allowed. It was,however, seen that the value as adopted for the computation of the deduction included cost (depreciated value Rs.165.55 lakhs)of machinery put to use during the previous year relevant to the assessment year 1979-80(immediately preceding assessment year). As no deduction was admissible in the assessment for the assessment year 1980-81, the error resulted

in an incorrect carry forward of investment allowance of Rs.41.39 lakhs having a potential tax effect of Rs.26.69 lakhs.

(v) In case of 7 companies in Uttar Pradesh, investment allowance was granted on machineries in the year of their use for the purpose of production, while the machineries were purchased in a year other than the immediately preceding year. The irregular allowance granted led to short levy of tax aggregating to Rs.31.40 lakhs. In the case of 2 other companies, investment allowance was incorrectly allowed on assets acquired/installed but not put to use for the purposes of production during the relevant previous years. In one case, the claim of the allowance on addition of assets worth Rs.3,372.84 lakhs relating to expansion/setting up of power project unit was initially not allowed on the basis of non-creation of statutory reserve; but on the basis of C.I.T.(Appeal)'s directions to allow it if all other conditions and requirements of law were fulfilled, the deduction was allowed although the assets in question,as per Director's Report, were not put to use in the relevant previous year for production of energy in which the assessee was dealing. In the other case, assets were acquired after the close of the crushing season in the relevant previous year of the sugar factory of the assessee.The irregular grant of investment allowance led to short levy of tax (potential) of Rs.475.36 lakhs in one case and Rs.8.40 lakhs (positive) in other case aggregating to Rs.483.76 lakhs.

Statutory requirements

2.02.13 In order to ensure that there is no bogus or undue claim and that the moneys provided by way of the deduction on account of investment allowance were not frittered away for non-business purposes, the law required compliance of certain statutory requirements viz.,

(a) Furnishing of prescribed particulars,

(b) Creation of a reserve in the specific year, and

(c) Retention of the reserve for a certain period pending utilisation for acquisition of new assets.

Non-compliance of these provisions were noticed in a number of cases.

1. Under the Rules framed under the Act, an assessee is required to furnish the description of assets, actual cost of assets acquired and the investment allowance claimed (indicate rate). However, before allowing the investment allowance certain conditions attached to its grant such as whether the asset acquired was new or second hand, the dates of its installation and first use, the fact of creation of a reserve to the prescribed extent, etc., are required to be verified. This necessitates the calling for the particulars not statutorily provided for in the rule.

2. According to the rules framed under the Income-tax law, the deduction for investment allowance was allowed only if the assessee had furnished the prescribed particulars in respect of the relevant capital assets viz., description of assets, actual cost of assets acquired during the previous year, investment allowance claimed and report of audit of accounts in the case of investment deposit.

(i) In 24 cases assessed in Assam, Kerala, Maharashtra, Rajasthan, Karnataka, Haryana (UT), Andhra Pradesh, Orissa and Uttar Pradesh circles, investment allowance of Rs.1519.47 lakhs carrying revenue effect of Rs.855.76 lakhs, for the assessment years 1975-76 to 1989-90 were allowed, though the assessees had not furnished the statutory particulars in the prescribed proforma.

(ii) In Maharashtra circle, in one case the assessee claimed an amount of Rs.33.48 lakhs as investment allowance for the assessment year 1979-80. As the company had not furnished the details of the machineries which were used for the manufacture of sanitary-ware and table-ware, an amount of Rs.25 lakhs was granted by the department on ad-hoc basis. The company had not furnished

the details till October 1990 and the ad-hoc allowance, in the absence of a specific provision in the scheme, was irregular. Revenue effect was Rs.13.91 lakhs.

(iii)(a) In Andhra Pradesh circle, in the assessment concluded in June 1982 for the assessment years 1979-80 and 1980-81, deduction towards investment allowance amounting to Rs.9.91 lakhs and Rs.7.12 lakhs respectively calculated at the higher rate of 35 per cent on investment in machinery costing Rs.28.30 lakhs and Rs.20.34 lakhs, was allowed. There was no evidence on record to justify the deduction at the higher percentage. Short levy of tax on the excess deduction of Rs.4.87 lakhs for the two assessment years amounted to Rs.3.10 lakhs.

(b) In the assessment of a company in which the public are substantially interested, for the assessment year 1984-85 which was completed in March 1987, investment allowance of Rs.18.56 lakhs on additions to plant and machinery valued at Rs.45.86 lakhs made during the previous year relevant to the assessment year 1984-85 was claimed and allowed by the assessing authority as against the admissible investment allowance of Rs.11.46 lakhs. The incorrect allowance resulted in underassessment of income of Rs.7.10 lakhs involving potential tax effect of Rs.4.10 lakhs.

The department has accepted the audit observation in principle.

(iv) In Madhya Pradesh circle, a private company engaged in the manufacture of tubes claimed for the assessment year 1988-89 investment allowance of Rs.27.30 lakhs on plant and machinery of Rs.123.93 lakhs acquired and installed in the business. As no evidence was produced to the effect that the assets were purchased before 12 June 1986 or that the assessee had entered into a contract for the purchase before that date, the incorrect allowance of investment allowance resulted in potential tax effect of Rs.15.77 lakhs.

(3) Under another provision in the Act,75 per cent of the investment allowance to be actually allowed was to be debited in the profit and loss account of the relevant previous year and credited to a reserve account prescribed for the purpose. Interpreting that provision, the Supreme Court had held that for claiming development rebate, creation of the reserve by passing book entires was essential irrespective of the profit or loss reflected in the books of the assessee.

(i) In 84 cases assessed in Tamil Nadu, Karantaka, Madhya Pradesh and Kerala circles, the Department had allowed investment allowance of large amounts, though the statutory reserve was either not created or the amount of reserve created fell short of the required quantum in the year of claim. The irregular grant of investment allowance involved substantial under-charge of tax of Rs.38.83 crores.

By the Finance Act, 1990 the Government amended the law retrospectively from 1 April 1976 clarifying that the condition for creation of requisite reserve would stand satisfied if the total of the reserve created either in the year of acquisition or installation or use or in any subsequent year or years of profits was equal to 75 per cent of the actual investment allowance in any year or years.

(ii) The Department had also allowed investment allowance of Rs.795.83 lakhs though the statutory reserve was either not created at all or not created to the required extent, even though there was profit in the relevant years, but was created in subsequent years in 43 cases involving undercharge of tax of Rs.462.31 lakhs in 12 circles.

Excepted items

2.02.14 Going by the intention behind the legislation, investment allowance was prohibited in respect of assets which were not used for or were not relevant to manufacture or production or which were allowed to be fully deducted. As such, no investment allowance on machinery or plant

was admissible in respect of office appliances, road transport vehicles or machinery or plant installed in any office premises or any residential acommodation, or in respect of machinery or plant the actual cost whereof was allowed as deduction by way of depreciation or otherwise in any one year.

Test-review, however, revealed that Investment allowance was allowed on technical know how, road transport vehicles, electric installation,etc., air conditioners installed in guest house, and plant or machinery which were allowed 100 per cent deduction.

The investment allowance so allowed involved revenue of Rs.725.82 lakhs, the broad break-up of which is:

Nature of assets	Circle	No. of cases	Assessment year	Investment allowance (in lakhs of rupees)	Tax effect
Office appliances and assets installed in office premises	Madhya Pradesh, Punjab	5	1978-79 to 1988-89	673.91	379.06
Technical know-how	Tamil Nadu	1	1986-87	3.17	1.95
Road transport vehicles	Punjab, Assam, Maharashtra, Uttar Pradesh	12	1979-80 to 1986-87	534.96	332.79
Air-conditioners in guest house	Punjab	2	1980-81 to 1985-86	2.06	1.27
Plant or machinery fully deducted by way of depreciation/ scientific research expenditure	West Bengal, Madhya Pradesh, Uttar Pradesh, Maharashtra	7	1977-78 to 1988-89	18.41	10.75

Breach of conditions

2.02.15 Investment allowance being allowed subject to prescribed conditions, any breach or violation of the conditions would attract withdrawal of the allowance. These fall under 4 categories:

(a) Sale or transfer of assets within 8 years;

(b) Non-utilisation of the reserve to acquire new assets within the prescribed period of ten years;

(c) Utilisation of the reserve for prohibited purposes during the period;

(d) Withdrawal of the reserve within the prescribed period of 10 years.

(1) Investment allowance earlier allowed would be treated as having been wrongly allowed and withdrawn, if at any time before the expiry of eight years from the end of the previous year in which the asset was acquired or installed, the machinery or plant was sold or otherwise transferred to any person other than Government or a local authority etc.

(i) In 26 cases assesseed in West Bengal, Punjab, Uttar Pradesh, Tamil Nadu, Karnataka, Gujarat, Delhi, Maharàshtra and Andhra Pradesh circles, investment allowance of Rs.657.92 lakhs granted during assessment years 1979-80 to 1986-87 was not withdrawn even though the assessees had sold/transferred the assets within a period of 8 years in which they were acquired or installed. The omission to rectify the assessments resulted in non-levy of tax of Rs.385.56 lakhs.

(ii) In West Bengal circle, 11 assessee companies, all belonging to the private sector, sold plant and machinery costing Rs.2122.45 lakhs between the assessment years 1976-77 and 1988-89. The assessees did not furnish nor did the department obtain details of these assets, about the year in which the assets were bought and put to use and how much development rebate/investment allowance was allowed on them. In the absence of such details on record, the amount of allowance, if any to be withdrawn could not be verified and the revenue effect could not be quantified.

(2) Where the amount credited to the reserve account was not utilised for the acquisition of new asset for the purposes of the business of the undertaking or was utilised for

distribution by way of dividends or profits etc., the deduction for investment allowance earlier allowed will be forfeited.

In 31 cases assessed in Gujarat, Delhi, Madhya Pradesh, Punjab, West Bengal, Maharashtra, Uttar Pradesh and Andhra Pradesh circles, the aforesaid requirements were not fulfilled and the reserves were utilised for declaration of dividends and there was no evidence regarding utilisation of the reserve for purchase of new assets. Test audit, however, revealed non-initiation of proceedings for withdrawal of the investment allowance of Rs.1721.05 lakhs allowed involving tax effect of Rs.995.23 lakhs.In some cases the reserves were credited to the profit and loss account after the prescribed period of 10 years.

Computation of cost

2.02.16 Investment allowance was allowed on real capital assets on the actual cost to the assessee at the time of acquisition and it was also not intended to undergo any variation with change in rate of exchange of currency.

(a) Mere capital expenditure on account of replacement, modernisation or modification of any plant and machinery already installed and put to use in any earlier previous year without any real additions to new plant or machinery will not entitle an assessee to investment allowance.

It was, however, noticed that in 6 cases relating to assessment years 1983-84 to 1989-90 the Department had allowed investment allowance of Rs 121.48 lakhs on money spent on modernisation, modification and replacements of capital on consumption of stores account, and on preoperative expenses. This involved under charge of tax of Rs.75.43 lakhs in six cases in Tamil Nadu, Uttar Pradesh and Madhya Pradsh circles.

(b) Portion of the cost of the asset if any, as has been met directly or indirectly by any other person or authority is to be excluded from the cost.

On the question whether subsidy granted under the Central Subsidy Scheme to industries on the basis of the fixed capital assets would be deductible in computing the actual cost, courts have held different views. According to a clarification issued in March 1976 by the Central Board of Direct Taxes, subsidy was deductible; this has not been reviewed even after the divergence in court decisions.

Over the assessment years 1983-84 to 1988-89 there was incorrect grant of investment allowance in 35 cases in Assam, West Bengal, Gujarat, Delhi, Maharashtra, Madhya Pradesh, Orissa, Punjab and Uttar Pradesh circles on the amount of subsidy and insurance which were received by the assessee companies. This involved short levy of tax of Rs.207.96 lakhs inclusive of potential tax.

(c) The actual cost of an asset acquired from a country outside India was to be increased or decreased if there was an increase or reduction in the liability of the assessee as a consequence of change in the rate of exchange at any time after the acquisition of such assets for the purposes of depreciation. Investment allowance on the cost was to be allowed in the year of installation or in the very next year in which it was brought to use and the above provision was not to be taken into consideration in computing the actual cost of an asset for the purposes of investment allowance. The majority view of courts in the matter is that the above provisions would be applicable in the determination of cost for the purposes of development rebate and so for investment allowance.

It was observed that the department had allowed investment allowance of Rs.59.11 lakhs on such enhanced cost which involved short levy of tax of Rs.32.06 lakhs in 4 cases in West Bengal, Tamil Nadu, Gujarat and Uttar Pradesh charges over the assessment years 1977-78 to 1987-88.

(d) For purposes of investment allowance, so much ofany amount paid or payable in connection with the acquisition of an asset

as is relatable to any period after such asset was first put to use, was not to be included in the actual cost of the asset. The Central Board of Direct Taxes also clarified in September 1985 that interest payments relating to the period after commencement of production or installation of machinery, cannot be capitalised and therefore, no investment allowance or depreciation can be allowed on the capitalised amount consisting of such interest including future interest.

Investment allowance of Rs.78.01 lakhs with revenue effect of Rs.44.78 lakhs (inclusive of potential tax effect) was, however, allowed on such interest payment in nine cases in West Bengal, Tamil Nadu and Punjab circles over the assessment years 1983-84 to 1987-88.

(e) Under the Income-tax Act, 1961, deduction on account of investment allowance is calculated on the basis of actual cost of the plant and machinery installed and used for the purpose of business. The Act permits the deduction being allowed in the immediately succeeding year in which the plant and machinery is first put to use but not at any time later on if these cannot be used in the year of installation. Further, the expenditure incurred, in the nature of deferred revenue payment before commissioning of the plant for production and capitalised on prorata basis, is not to be included in the cost of plant and machinery.

In the assessment of a private limited company for the assessment year 1986-87 completed in March 1989 investment allowance of Rs.33.77 lakhs as claimed was allowed on Rs.135.07 lakhs being the cost of plant and machinery. The whole unabsorbed investment allowance was further allowed to be carried forward for set off against future profits. Audit scrutiny (February 1990) revealed that plant and machinery on which investment allowance was allowed included a sum of Rs29.29 lakhs on account of preoperative deferred revenue expenditure capitalised on prorata basis in the assessment year 1986-87 and machinery worth Rs.13.11 lakhs installed

in the previous year relevant to assessment year 1984-85 which were not used either in the year of installation or in the immediately succeeding previous year but in the third previous year relevant to assessment year 1986-87. No investment allowance was allowable on the capitalised deferred revenue payments and on the cost of machinery not used in the year of installation or immediately succeeding previous year. The mistakes resulted in incorrect carry forward of unabsorbed investment allowance of Rs.10.60 lakhs involving potential tax effect of Rs.6.12 lakhs.

Incorrect allowance, carry forward and set off of unabsorbed investment allowance

2.02.17(1) Where the total income, before considering the investment allowance and Chapter VIA deductions, for the assessment year relevant to the previous year in which the machinery or plant was installed or the immediately succeeding previous year, is nil or less than the full amount of the allowance, the deduction would be allowed to the extent of the total income and any balance remaining unabsorbed, carried forward to the following assessment year or years upto and including the 8th assessment year immediately succeeding the relevant succeeding assessment year.

(a) In Karnataka and Delhi charges, in 8 cases investment allowance of Rs.407.38 lakhs was allowed to be carried forward beyond the eight assessment years involving tax effect of Rs.206.73 lakhs.

(b) In Karnataka, Delhi and Madhya Pradesh circles, carry forward of incorrect amounts of unabsorbed investment allowance of Rs.128.33 lakhs in ten cases led to undercharge of tax of Rs.79.52 lakhs.

(c) In West Bengal, Maharashtra, Punjab and Tamil Nadu circles, 9 assessee companies were allowed in assessment years 1977-78, 1978-79, 1984-85 to 1988-89 set off of a total investment allowance of Rs.177.06 lakhs carried forward from earlier assessment years as unabsorbed allowances. Audit scrutiny revealed that there were no such unabsorbed

amounts to be carried forward as in the earlier years, the investment allowance had been denied by the assessing officers or had been varied in subsequent revisional orders or the investment allowance originally allowed had been reduced in appeals. In one case, there was also carry forward of the same amount in two successive assessment years. The incorrect carry forward and set off resulted in under-charge of tax of Rs.102.43 lakhs.

(2)(a) Under the scheme if a deduction is allowed towards investment allowance, no deduction is allowable under Investment deposit account for the same year. From the assessment year 1989-90, if a deduction has been allowed under Investment Deposit Account in any assessment year, no deduction shall be allowed to the assessee towards investment allowance in the said assessment year and a further period of four years beginning with the assessment year immediately succeeding the initial assessment year.

Audit scrutiny of the assessments of two companies in Karnataka circle, revealed that they were allowed the benefit of investment deposit account in the assessment year 1988-89. They claimed investment allowance for the assessment year 1989-90 which was also allowed.As the assessees were allowed the benefit of investment deposit for the assessment year 1988-89, they had to continue to claim the benefit of investment deposit for the succeeding four years. Irregular deduction allowed for investment allowance for the assessment year 1989-90 amounting to Rs.6.69 lakhs resulted in short levy of Rs.3.47 lakhs.

(b) In the assessment for the assessment year 1989-90 in Andhra Pradesh circle concluded in February 1990, deduction towards investment allowance amounting to Rs.75.56 lakhs on additions to plant and machinery costing Rs.377.81 lakhs as claimed by the assessee company was accepted and was allowed to be carried forward. As per the details filed with the assessment records, the total investment in plant and machinery worked out

to Rs.337.81 lakhs only on which the admissible investment allowance was Rs.67.56 lakhs. The error resulted in excess allowance of deduction of Rs.8.00 lakhs having a potential tax effect of Rs.4.62 lakhs.

(c) According to the provisions contained in law and as clarified by the Central Board of Direct Taxes, unabsorbed investment allowance is to be set off only after setting off of unabsorbed depreciation. Further, due to restriction on certain deductions in the case of a company (Chapter VI B of the Income-tax Act) for the assessment years 1984-85 to 1987-88, the aggregate amount of deduction admissible under certain provisions of the Act was not to exceed 70 per cent of the amount of the total income as computed before making any such deduction. Investment allowance is one of the deductions specified for the purpose of applying the aforesaid restriction.

In the case of a company in Tamil Nadu circle, unabsorbed investment allowance of Rs.337.80 lakhs was allowed as deduction from the total income for the assessment year 1983-84 before setting off of unabsorbed depreciation which amounted to Rs.1195.44 lakhs. The incorrect deduction resulted in a potential tax loss of Rs.177.35 lakhs.

For the assessment years 1984-85 to 1987-88, incorrect set off of unabsorbed investment allowance before considering the set off of unabsorbed depreciation and non-application of the provisions of Chapter VIB resulted in potential loss of Rs.237.61 lakhs due to priority set off of investment allowance of Rs.441.02 lakhs.

(d) In the case of a company in Madhya Pradesh circle, on plant and machinery, costing Rs.147.52 lakhs (including interest of Rs.7.05 lakhs) put to use during the relevant previous year, investment allowance of Rs.36.88 lakhs was allowable in the assessment year 1983-84 as against Rs.47.80 lakhs computed by the assessing officer. The mistake resulted in excess allowance of

Rs.10.92 lakhs with consequential short levy of tax of Rs.6.16 lakhs.

(e) In case of another company, for the previous year from 1 October 1987 to 31 March 1989 relevant to the assessment year 1989-90, the assessing officer allowed investment allowance of Rs.74.55 lakhs being 25 per cent of the cost of machinery of Rs.298.20 lakhs.As from the assessment year 1989-90, the allowance was admissible at 20 per cent, the mistake resulted in excess grant of allowance of Rs.14.91 lakhs involving a potential tax of Rs.8.20 lakhs.

(f) Investment allowance was withdrawn by Government notification dated 12 June 1986 in respect of machinery or plant installed after 31 March 1987 i.e. for the assessment year 1988-89. Deduction for investment deposits account was, however, admissible with effect from 1 April 1987 only when the accounts of the assessee were audited by an accountant and the report of such audit was furnished alongwith the return of income in the prescribed form.

In the assessment of a public limited company for the assessment year 1988-89 completed by the Deputy Commissioner of Income-tax in March 1990, investment allowance of Rs.69.18 lakhs for installation of machinery worth Rs.276.71 lakhs was claimed and deduction was allowed for Rs.56.00 lakhs as the reserve created was to the extent of Rs.42 lakhs only. As the assessee was not entitled to investment allowance for assessment year 1988-89 as it stood withdrawn for that assessment year, the incorrect grant of investment allowance resulted in underassessment of income by Rs.56 lakhs involving short levy of tax of Rs.29.40 lakhs.

The department has accepted the audit observation.

Investment deposit account

2.02.18 With effect from the assessment year 1987-88 where an assessee had, out of his business income, deposited any amount in the deposit account with the prescribed

Development Bank (Industrial Development Bank of India) within a period of six months from the end of the previous year or before furnishing the return of income, whichever was earlier, or had utilised any amount during the previous year for the purchase of new ship, new aircraft or new machinery or plant, the assessee was allowed a deduction of a sum equal to the amount so deposited and any amount so utilised or a sum equal to 20 per cent of the profits of eligible business or profession, i.e. business or profession other than the business of construction, manufacture or production of any article or thing specified in the list in the Eleventh Schedule to the Income-tax Act, carried on by an industrial undertaking, the business of leasing or hiring of machinery or plant to such an industrial undertaking, in either case not being a small scale industrial undertaking.

The amount standing to the credit of the assessee in the deposit account was not allowed to be withdrawn during a period of five years from the date of deposit except under certain circumstances, and if in any case it was withdrawn during the prohibited period, the whole of such amount would be assessed as business income and if any amount in the deposit account was utilised for the purposes of any expenditure in connection with the eligible business, the expenditure will not be allowed as business expenditure. Under the scheme, the amount deposited could be utilised for purchase of new asset for purposes of business or purchase of new computers for office or place of business, or repayment of term loans taken for a period of 3 years or more contracted after 31 March 1986 from a financial institution or scheduled bank or other institution as specified. Any failure in this regard will invite assessment of the amount not so utilised as business income. While the scheme was not applicable to the purchase of certain excepted items as in the case of investment allowance, sale or transfer of the assets so purchased entailed withdrawal of the deduction earlier allowed in computing business income.

Some of the points noticed in audit of the provisions relating to investment deposit account are:

West Bengal

A pharmaceutical company was allowed deduction of Rs.33.59 lakhs under Investment Deposit Scheme in the assessment year 1987-88(assesment completed in January 1989 and revised in April 1990). As per the prescribed particulars furnished by the accountant of the company, it appeared that deduction of Rs.27 lakhs was allowed for deposit with the I.D.B.I. and Rs.6.59 lakhs for purchase of new plant and machinery during the relevant previous year. But scrutiny of the audited accounts and balance sheet of the assessee company revealed that the total purchase of new plant and machinery during the previous year relevant to the assessment year 1987-88 was Rs.6.35 lakhs and not Rs6.59 lakhs on which deduction was allowed. Thus, there was an excess grant of allowance of Rs.24,243 under investment deposit scheme with resultant under-charge of tax ofRs.13,333. Further as per statutory provisions, the deposit of Rs.27 lakhs was required to be made out of profits chargeable to tax. Scrutiny revealed that the company used to transfer its profit after appropriating for tax to general reserve each year.The general reserve figure stood at Rs.2.15 crores at the close of the acounting year relevant to the assessment year 1987-88. As there was no transfer of fund from current years profit or any withdrawal made from general reserve for depositing Rs.27 lakhs with the IDBI, the amount appeared to have not been deposited out of profits of the company charged to tax. Thus the amount of Rs.27 lakhs was apparently allowed irregularly as deduction from income resulting in under-charge of tax of Rs.14.85 lakhs.

(2) An assessee company in its return of income for the assessment year 1987-88 claimed a deduction of Rs.1.46 crores towards investment deposit calculated at 20 per cent of profit of Rs.7.34 crores in the prescribed manner. While completing the assessment for

that year in March 1990 the Deputy Commissioner of Income-tax determined the qualifying deduction at Rs.1.33 crores which was allowed in assessment. It was noticed in audit that the aforesaid profit of Rs.7.34 crores which formed the basis of calculation for the claim of investment deposit deduction included income from dividend and interest amounting to Rs.35.98 lakhs to be assessed as income from other sources and cannot be treated as profit from eligible business to warrant the deduction towards investment deposit. Accordingly, an amount of deduction of Rs.7.20 lakhs should have been disallowed in the assessment. The mistake resulted in excess allowance of deduction of Rs.7.20 lakhs and underassessment of total income by similar amount involving undercharge of tax of Rs.5.04 lakhs.(including surtax).

(3) In the assessment for the assessment year 1987-88 of a company, in which public are substantially interested and which is engaged in the business of growing and manufacturing tea, completed by the Deputy Commissioner of Income-tax in November 1989, deduction under this provision was allowed to the extent of Rs.184.01 lakhs being twenty per cent of the total profit of Rs.920.06 lakhs. As the profit of Rs.920.06 lakhs included non-business income of Rs.115.59 lakhs from `Other sources', there was excess allowance of deduction of Rs.23.12 lakhs (20 per cent of Rs.115.69 lakhs ineligible for deduction). The consequent under assessment of income was Rs.9.25 lakhs (40 percent of Rs.23.12 lakhs) and tax under charge was Rs.4.62 lakhs.

Ministry of Finance have accepted the audit observation.

4. The Act also provides that assets qualifying for 100 per cent deduction under the other provisions of the Act, will not qualify for such deduction.

In the assessment for the assessment year 1987-88, completed in November 1989, a company carrying on an eligible business was allowed deduction towards investment deposit

of Rs.13.23 lakhs being 20 percent of profits of the eligible business for the relevant previous year. In allowing the deduction, the assessing officer considered the cost of new plant and machinery at Rs.56.02 lakhs. Audit scrutiny, however, revealed that the amount of Rs.56.02 lakhs included the cost of assets lying under capital work-in-progress (Rs.48.18 lakhs) and accordingly not put to use to warrant the deduction, and plant and machinery worth Rs.5.99 lakhs for which 100 percent deduction was allowed in assessment towards depreciation and capital expenditure on scientific research. The assessee was, therefore, entitled to a deduction of Rs.1.85 lakhs only towards investment deposit. The excess allowance of deduction resulted in under assessment of total income by Rs.11.38 lakhs involving under charhge of tax of Rs.6.26 lakhs.

5. The Act further provides that where separate accounts for eligible business are not maintained or are not available, the profits of eligible business shall be such amount which bears to the total profits of business of the assessee, the same proportion as the total sales, turnover or gross receipts of the eligible business bear to the total sales, turnover or gross receipts of the business carried on by the assessee.

A private limited company engaged in the business of manufacture and sale of pharmaceutical products and hair oil deposited a sum of Rs.20 lakhs with the Industrial Bank against investment deposit account in the previous year relevant to the assessment year 1987-88. According to the Tax Audit Report and notes to the final accounts for the previous year ended 14 April 1987, the sale value of products of `eligible business' was Rs.308.77 lakhs out of total sales of various products of Rs.2186.56 lakhs. The balance sum of Rs.1877.79 lakhs represented sales of products of non-eligible business comprising cosmetic or toilet preparations specifically mentioned in the Eleventh Schedule to the Income-tax Act, 1961, to be excluded for the purpose of deduction against investment deposit account.

In the assessment of the company made in March 1990, the assessing officer allowed the entire sum of Rs.20 lakhs deposited as deduction. There was no separate profit and loss account in respect of eligible business and no indication either in the Tax Audit Report regarding profit earned by eligible business. Therefore, the profits earned by the eligible business was required to be assessed on proportionate basis. Since the sale value of eligible business was 14.12 per cent of total sales during the previous year, the profit attributable to eligible business would work out to Rs.14.35 lakhs compared to Rs.101.66 lakhs shown as profit of the business as a whole in the Tax Audit report. The deduction for investment deposit account thus worked out to Rs.2.87 lakhs as against Rs.20 lakhs allowed. The incorrect deduction allowed in assessment led to under assessment of income of Rs.17.13 lakhs and short levy of tax of Rs.9.42 lakhs in assessment year 1987-88.

Assam

The Auditors statement of particulars relating to the claim of deduction made in the assesment year 1989-90 by the assessee revealed that the deduction towards investment deposit of Rs.39.76 lakhs was calculated at 20 per cent of the amount of profits computed at Rs.198.78 lakhs which also included agricultural income of Rs.147.41 lakhs. According to the profit and loss account, there were agricultural farm expenses of Rs.52 lakhs.The net agricultural income therefore worked out to Rs.95.41 lakhs which was not profit of eligible business. The incorrect allowance of deduction at 20 per cent on agricultural income of Rs.95.41 lakhs resulted in under-assessment of income by Rs.19.08 lakhs with consequential short levy of tax of Rs.10.02 lakhs.

Haryana

In the case of a company, for the assessment year 1988-89, a deduction of Rs.53.24 lakhs on account of additional cane price payable was allowed. While working out the profits of

the assessee company for the purpose of relief under section 32AB,the said deduction of Rs 53.24 lakhs was not taken into account.This resulted in excess relief of investment deposit account of Rs.10.64 lakhs involving short levy of tax of Rs.5.59 lakhs.

Maharashtra

(i)In the assessment of a company for the assessment year 1988-89, completed under the summary assessment scheme in October 1988,deduction of Rs.16.84 lakhs in respect of investment deposit account was allowed being 20 per cent of the profits from business. It was seen in audit that the company derived the business profit from leasing business which was not eligible business as defined under the Act,for the purpose of allowing deduction under investment deposit account.It was also seen in audit that the company commenced leasing operation from this year and disbursed lease finance towards acquiring equipment for giving on lease.The allowance of deduction of Rs.16.84 lakhs resulted in under assessment of income to that extent with short levy of tax of Rs.8.84 lakhs.

(ii) The deduction is available, inter-alia, to the amount utilised for the actual purchases of plant and machinery. In other words, an amount utilised merely as an advance for purchase of machinery would not be eligible for the deduction.

In the assessment of a company for the assessment year 1987-88 completed by the Deputy Commissioner of Income-tax in March 1990, a deduction of Rs.20.05 lakhs being 20 percent of the net profit of business during the relevant previous year, towards investment deposit account on purchase of machinery costing to Rs.24.65 lakhs was allowed as claimed. Audit scrutiny, however, revealed that the machinery actually acquired during the relevant previous year was to the extent of Rs.0.50 lakhs only and the aforesaid amount of Rs.24.65 lakhs was towards advances made for purchase of machinery and not amounts spent in actual

purchase. As advances for purchase do not qualify for deduction under these provisions, the assessee was entitled to deduction of Rs.0.50 lakhs only as against Rs.20.05 lakhs allowed by the assessing officer. The mistake resulted in excess allowance of Rs.19.55 lakhs involving short levy of tax of Rs.9.77 lakhs. Consequently excess interest of Rs.34,737 paid on excess advance tax was also required to be recovered from the assessee. The total short levy was Rs.10.12 lakhs.

Punjab

In the assessment for the assessment year 1989-90,an assessee company was allowed, under section 32AB of the Act, deduction amounting to Rs.40.73 lakhs being the amount deposited in the Development Bank and the amount utilised for the purchase of new machinery and plant, as this amount was less than twenty per cent of profits of Rs.2.08 crores.The profit included the following income:

Income from sale of fixed assets	Rs.34.27 lakhs,
Rental Income	Rs. 4.44 lakhs,
Interest income from fixed deposits and	Rs.3.88lakhs,
Dividend income	Rs 0.37 lakhs

As the income of Rs.42.96 lakhs was not income under the head `Profits and gains of business or profession, it was not eligible for deduction under Section 32AB. The admissible deduction, therefore, worked out to Rs.32.97 lakhs (20% of Rs.1.65 crores i.e. Rs.2.08 crores less Rs.42.96 lakhs) as against Rs.40.73 lakhs actually allowed. There was under assessment of income of Rs.7.76 lakhs with revenue effect of Rs.4.07 lakhs.

Madhya Pradesh

(i) In the case of a banking company, incorrect deduction of allowance of Rs.28.12 lakhs in respect of purchase of data entry machines and advance ledger posting machines

was allowed though the machines were office appliances and installed in office premises. The incorrect deduction resulted in short levy of Rs.14.76 lakhs in assessment year 1988-89.

(ii) In yet another case of a company, a deduction of Rs.27.52 lakhs was allowed for the assessment year 1988-89. From the accounts of the assessee it was observed that it had received investment subsidy of Rs.10 lakhs which would not be considered for the purpose of cost of plant and machinery. The irregular grant of deduction of Rs.10 lakhs resulted into short levy of tax of Rs.5.25.lakhs.

Tamil Nadu

In the assessment of a company for assessment year 1988-89 completed by the Deputy Commissioner of Income-tax in September 1988 (revised in June 1989) on a total income of Rs.39.29 lakhs, a deduction of Rs.21.25 lakhs was allowed at twenty per cent of the profits of eligible business of Rs.106.23 lakhs towards investment deposit account for the purchase of new machinery costing Rs.22.02 lakhs during the previous year. Audit scrutiny in January 1991 revealed that the assessee company was sanctioned a term loan of Rs.27 lakhs by a State Financial Corporation in December 1986 which was utilised by the company for the purchase of the new machinery. In as much as the machinery was not purchased out of the income chargeable to tax under the head `Profits and gains of business or profession', the deduction of Rs.21.25 lakhs allowed towards investment deposit account was not in order. The mistake resulted in under-assessment of income of Rs.15.93 lakhs (after allowing proportionate relief in respect of new industrial undertaking) involving short levy of tax of Rs.9.20 lakhs for the assessment year 1988-89.

2.03 REVIEW ON EXPORT INCENTIVES

2.03.1 Recognising the urgent need for closing the gap in trade balance and the

contribution of exports to the economic development of the country, the Government has launched various schemes, such as Duty Drawback, Cash Compensatory support etc., aimed at sustained growth in exports. (Export subsidies have since been abolished with effect from 3 July 1991) As part of such effort, incentives have also been provided in the Income-tax Act, some of which are :

(i) Tax exemption in respect of newly established industrial undertakings in free trade zones (S.10A)

(ii) Tax exemption in respect of newly established hundred per cent export-oriented undertakings (S.10B).

(iii) Deduction in respect of profits and gains from projects outside India (Sec.80HHB)

(iv) Deduction in respect of profits retained for export business, including incentives for supporting manufacturers selling through Export Houses and Trading Houses.(S.80HHC).

(v) Deduction in respect of earnings in convertible foreign exchange by hotels, tour operators or travel agents (Sec.80HHD).

(vi) Deduction in respect of royalties, commission, fee etc. received from certain foreign enterprises (Sec.80-O).

Law and Procedure

2.03.2

(a) Section 10A

On the statute book with effect from 1 April 1981,this section applies to newly established industrial undertakings located in any free trade zone. The income from such units is completely exempt for five consecutive assessment years within a block of eight years beginning from the assessment year in which the unit commences production. The assessee has to furnish a written declaration, before the due date of furnishing the return, intimating his choice of the said five years. The section provides for a liberal definition of manufacture which

includes any process or assembling or recording of programmes on any disc, tape, perforated media or other information storage devices.

(b) Section 10B

This section, effective from 1 April 1989, applies to newly established 100 per cent export oriented units, manufacturing or exporting any article or thing. As provided in section 10A, 100 per cent tax exemption of income is available for a period of five consecutive assessment years within a period of eight years beginning from the assessment year in which the unit commences production. Other conditions regarding allowance of the exemption, including the liberal definition of manufacture, are similar to those in Section 10A. It has also been provided that only those units which have been approved as 100 per cent export-oriented undertakings by a Board appointed by the Central Government, will be so considered, under this section.

(c) Section 80 HHB

With effect from Ist April 1983, a deduction is available on profits and gains derived from projects executed outside India. Upto 25 percent of such profits were exempt under this provision. From 1 April 1987, the deduction has been enhanced to 50 per cent. For admissibility of this concession, consideration for the project should be payable in convertible foreign exchange. It is clarified in the section itself that a foreign project would include construction of any building, road, dam, bridge or assembly or installation of any machinery or plant outside India. In order to avail of this benefit, the assessee is legally required to maintain separate accounts in respect of the foreign project. The assessee has also to maintain a reserve account' of an amount equivalent to the 50 percent of the profits to be utilised within 5 years for purposes of business, other than distribution by way of dividends or profits.

(d) Section 80 HHC

This section is in operation from 1 April 1983 and provides for a deduction in respect of profits retained for export business. The deduction was originally turnover based and allowed, by way of deduction, an amount of 1 per cent of export turnover and 5 per cent of the incremental turnover. From 1 April 1986, the deduction admissible was 50 percent of export profit. From 1 April 1987, the admissible deduction was made equal to the aggregate of 4 per cent of net foreign exchange realisation and 50 per cent of so much of the export profits as exceed 4 per cent of the net foreign exchange realisation, subject to the overall condition that the aggregate deduction did not exceed the export profits. From 1 April 1989, the entire profits from exports are exempt. Exports of agricultural primary commodities, mineral oil and minerals and ores do not qualify for this deduction. Upto 31 March 1989, there was also a condition that a reserve should be created of an amount equivalent to the amount of deduction, to be utilised for purpose of business. This condition was withdrawn from 1 April 1989 from which date, supporting manufacturers, selling goods or merchandise to any Export House or Trading House are also allowed this benefit. One of the eligibility conditions is that sale proceeds are received or brought into India in convertible foreign exchange. In a case where the business does not consist exclusively of the business of exports, the qualifying export profits is required to be worked out on pro-rata basis. The terms `convertible foreign exchange and `export turnover' have been defined in the Act. From 1.4.91, total turnover has also been defined so as not to include amounts received by way of cash compensatory support, duty drawback and export replenishment.

(e) Section 80 HHD

With effect from 1 April 1989, a deduction is admissible for persons engaged in the business of a hotel or of a tour operator, or an approved travel agent. The amount of deduction admissible is the aggregate of 50

per cent of profits derived by the assessee from services provided to foreign tourists, and so much of the remaining profit as is debited to the profit and loss account and credited to a reserve account to be utilised for specified business purposes within the period of 5 years. The receipts from services provided have to be obtained in convertible foreign exchange. An accountant as defined in the Income-tax Act has to certify that the amount claimed as deduction is correct.

(f) Section 80-O

This deduction is admissible to an assessee who derives income by way of royalty, commission, fees, etc., from Govt. of a foreign state or a foreign enterprise,in consideration for the use outside India of any patent, invention, model, design, etc.,or information concerning industrial, commercial or scientific knowledge or in consideration of technical services rendered outside India. The income has to be received in convertible foreign exchange. On fulfilment of these and other prescribed conditions, a deduction upto 50 per cent of the income received is available.

Scope of Audit

2.03.3 The Audit review attempted an evaluation of the manner of implementation of the schemes of the incentives for exporters. In respect of Section 80 HHB and Section 80 HHC, All-India Income-tax Statistics for 1987-88 gave the following figures:

Assessment Year	Section	No.of returns	Amount of deduction claimed	Tax effect (In crores of rupees)
1987-88	80 HHB	253	41.77	18.09
1987-88	80 HHC	5260	192.23	87.17

However complete details in regard to the total number of beneficiaries, the amount of deductions claimed/allowed with tax effect and the quantum of foreign exchange earned covering the entire spectrum of concessions allowed could not be obtained from the

Department. Audit reviewed 1878 cases relating to the assessment years 1986-87 to 1989-90, the results of which are outlined in the succeeding paragraphs.

Highlights

2.03.4(a) Although the avowed objective of the scheme was to encourage export earnings, there were no statistics available to show to what extent the various tax incentives contributed towards the declared goals. No review has been carried out by the Government to evaluate the impact of the schemes or to judge whether the revenue foregone by the Government was justifiable.

(b) Test check by Audit brings out numerous cases where the Assessing Officers committed mistakes arising out of incorrect application and understanding of the provisions of law relating to export incentives. In as much as 14 per cent (apprx.) of the cases test-checked in audit, there were mistakes and the total tax effect involved was Rs.1643.26 lakhs.

(c) In respect of 5 assessees in the jurisdiction of Bombay and West Bengal charges, due to wrong computation of profit from foreign projects and other reasons, there was short-levy of tax of Rs.79.10 lakhs in assessment years 1985-86 to 1987-88. Further, in respect of 33 assessees in the jurisdiction of Tamil Nadu, Kerala, West Bengal, Bombay and Assam charges, wrong computation of proportionate profit from export business (where the assessee was making both local and export sales), led to short-levy of tax of Rs.352.20 lakhs in the assessment years 1984-85 to 1989-90.

(d) Tax incentives were allowed in several cases where even basic conditions like creation of reserve or filing of statutory Auditors report, were not fulfilled. Such omissions in respect of 39 cases alone in Bombay, West Bengal, Madhya Pradesh, Tamil Nadu, Uttar Pradesh, Bihar, Orissa and Gujarat charges involved tax effect of Rs.255 lakhs,

(e) In most of the cases test checked, no

attempt was made to verify the correctness of F.O.B. value of exports (as exhibited by the assessee) with the bankers acting as agents of the Reserve Bank of India. Similarly, no attempt was made to have a reconciliation of figures with those maintained by the Chief Controller of Imports and Exports.

(f) The reserve to be created under Section 80 HHC, as it existed upto 31 March 1989, to avail of the concessions on export earnings had to be utilised for business purposes, though there was no time limit laid down for such utilisation, unlike the period specified in Sections 32A (relating to Investment Allowance) and 80 HHD (relating hotel industry etc.) Cases came to notice where the assessees created the reserve on the last day of the previous year, withdrew the same on the first day of the succeeding year and used the amount for purposes other than business. In 10 such cases in the jurisdiction of Bombay charge, the tax effect was Rs.34.14 lakhs, but no step was taken to withdraw the concession.

Detailed Review

2.03.5 In the absence of complete details, the overall efficacy of the scheme for export promotion could not be judged. There was no indication either as to whether the Department had carried out any comprehensive review of the scheme.

Out of the cases reviewed in audit, irregular allowance of the concession was noticed in as many as 268 cases which works out to 14 per cent approximately. The total tax effect involved was Rs.1643.26 lakhs. Some illustrative cases are enumerated below.

Deduction in respect of profits and gains from projects outside India

2.03.6 Under the provisions of Income-tax Act, 1961, where the gross income of an assessee, being an Indian company, includes any income from execution of foreign project undertaken by the assessee in pursuance of a contract entered into by him and consideration for such project is received in convertible foreign exchange, the assessee is entitled to a deduction from such profits and gains of an amount equal to twenty five

percent upto 31 March 1987 and fifty percent thereafter.

Bombay charge

(i) In one case, an expenditure of Rs.67.16 lakhs incurred on a foreign project was not considered in determining the profit from the foreign project for the purpose of allowing deduction under section 80HHB. It resulted in excess allowance of deduction of Rs.16.79 lakhs with tax effect of Rs.16.47 lakhs (including interest of Rs.5.01 lakhs) in the assessment year 1985-86.

(ii) In another case, an assessee had claimed deduction of Rs.118.92 lakhs in the assessment year 1987-88 which was restricted to Rs.49.86 lakhs u/s 80VVA and an amount of Rs.29.94 lakhs was allowed to be carried forward, but the assessee had created a reserve of only Rs.20 lakhs. Omission to restrict the claim to the extent of the reserve created resulted in excess allowance of deduction to the tune of Rs.29.86 lakhs and irregular carry forward of deduction of Rs.29.94 lakhs resulting in short levy of tax of Rs.29.90 lakhs (including potential tax effect of Rs.14.97 lakhs).

West Bengal charge

In the case of 3 assessees, the profit from foreign projects for the purpose of allowing deduction was incorrectly determined without deducting therefrom the amounts debited to profit and loss account representing adjustment of obsolete assets used in foreign projects, investment allowance on machinery and plant used in foreign projects and Head Office administration expenses etc. This resulted in excess allowance of deduction aggregating to Rs.57.96 lakhs involving tax effect of Rs.32.73 lakhs in the assessment years 1986-87 to 1987-88.

Deduction for persons engaged in the business of a hotel or a tour operator/ travel agent for services provided to foreign tourists.

Delhi charge

2.03.7 An assessee company, deriving income by organising tours for foreigners and travel agencies, was allowed deduction of Rs.35.75 lakhs for assessment year 1989-90 whereas the assessee was entitled to deduction of Rs.32.39 lakhs being fifty per cent of proportionate profit and reserve created. This resulted in excess deduction by an amount of Rs.3.36 lakhs resulting in undercharge of tax including surcharge and interest amounting to Rs.2.55 lakhs.

The department did not accept the objection stating that deduction was correctly allowed as the total receipts of only convertible foreign exchange in place of total receipts of the business have to be taken into account in a case where the business carried on by the assessee does not consist exclusively of services provided to foreign tourists. The department's plea is not correct as the provisions clearly stipulate that in such cases the amount which bears to the profits of the business (as computed under the head `Profits and gains of business or profession') the same proportion as the receipts in foreign exchange bear to the total receipts of the business carried on by the assessee is to be taken into account.

West Bengal charge

Deduction in respect of royalties, etc received from certain foreign enterprises

2.03.8 An assessee company was allowed deduction of Rs.73.99 lakhs (i.e. to the extent of available income) for the assessment year 1989-90. The deduction was computed on gross foreign income received as fee for services rendered in foreign country, but without deducting therefrom proportionate direct and indirect expenses incurred in securing the income from services rendered outside India. This was contrary to the provisions of the Income-tax Act. The mistake resulted in under-assessment of income of Rs.34.94 lakhs and consequent tax-effect of Rs.20.18 lakhs.

Irregular deductions in respect of profits retained for export business

Incorrect computation of export profit

2.03.9 Where the business of the assessee does not consist exclusively of export of goods/merchandise, profit derived from export shall be the amount which bears to the profit of the assessee as computed under the head,`Profits and gains of business or profession' the same proportion as export turnover bears to the total turn over.

Tamil Nadu charge

(i) In respect of seven cases concerning four assessees for the assessment years 1986-87 to 1989-90, it was seen that export profits had been incorrectly computed by adopting incorrect amounts of export turnover and total turnover while working out the proportionate profits from exports, resulting in excess allowance of deduction aggregating to Rs.98.98 lakhs involving tax effect of Rs.69.86 lakhs (including potential tax effect of Rs.77,000). Similarly in sixteen cases concerning ten assesses there was under assessment due to excess relief aggregating to Rs.25.43 lakhs due to incorrect working of export turnover as well as total turnover for the assessment years 1986-87 to 1989-90 resulting in short levy of tax of Rs.15.19 lakhs.

(ii) In the assessment of a widely held company for the assessment year 1986-87 deduction of Rs.23 lakhs towards relief in respect of export turnover was allowed as claimed by the assessee company. Audit scrutiny revealed that the profits from export unit was determined at Rs.109.03 lakhs by allocating the income and expenses as per trading and profit and loss account pro-rata between export unit and others. The relief admissible was then calculated with reference to such profits but limiting it to the amount of reserve of Rs.23 lakhs created. However, the profits from business as computed under the Act should have been distributed between the export unit and others on the basis of the proportion of the export turnover to the total turnover since the assessee's business included publishing and sale of books in

addition to exports. Omission to follow the correct method and failure to deduct expenditure of Rs.3.39 lakhs incurred on freight and insurance from the export profits resulted in excess allowance of relief by Rs.20.68 lakhs and under-assessment of income by Rs.19.70 lakhs after allowing further deductions towards investment allowance and carried forward unabsorbed depreciation relating to earlier years which were restricted due to application of the provisions of the Act to levy minimum tax. The consequential short levy of tax together with the interest for belated filing of return and non-filing of estimate of income for advance tax worked out to Rs.14.35 lakhs.

Kerala charge

For the assessment years 1986-87 to 1989-90, two assessees had income from both export and local sales. While working out the proportionate profits relating to export sales, the total turnover was computed erroneously by excluding sales turnover of goods on commission basis and business income from service contracts. This resulted in excess deduction of Rs.22.75 lakhs involving undercharge of tax of Rs.5.52 lakhs.

West Bengal charge

(i) An assessee company who had one hundred percent export oriented unit as well as other units which were not 100 percent export oriented, was allowed total deduction of Rs.1.75 crores for the assessment years 1986-87 and 1987-88. The export profit was computed incorrectly by adopting the ratio of the entire export sales to the total sales resulting in total excess allowance of Rs.1.12 crores for the two years involving tax effect of Rs.57.02 lakhs.

(ii) In the assessment of a public limited company for the assessment year 1987-88 relief towards export turnover for an amount of Rs.90 lakhs (limited to the amount of reserve created) was allowed as claimed by the assessee on the basis of export profit of Rs.177.20 lakhs determined by it on pro-rata

basis of total export turnover to the total turnover of the whole business of the relevant previous year. It was noticed in audit that one of the units of the assessee company was operated exclusively for export sale with separate accounts having been maintained therefor and the export profit derived by that unit during the relevant previous year amounted to Rs.54.15 lakhs qualifying for relief towards export turnover. The export profits earned by the other units not exclusively operated for export sale amounted to Rs.16.71 lakhs on pro-rata basis of export turnover to total turnover of the whole business as reduced by those derived from the exclusively export unit. Thus, the total export profit for the purpose of deduction towards export turnover amounted to Rs.70.86 lakhs entitling the assessee to a deduction of Rs.41.42 lakhs against the deduction of Rs.90 lakhs allowed in the assessment. The allowance of excess deduction resulted in under-assessment of total income by Rs.48.58 lakhs involving undercharge of tax of Rs.34.92 lakhs for the assessment year 1987-88 (including short levy of interest of Rs.10.63 lakhs for short payment of advance tax).

(iii) In the assessment of a public limited company for the assessment year 1986-87 the assessing officer allowed a relief towards export turnover for an amount of Rs.85 lakhs (limited to the amount of reserve created by the assessee for the purpose) against the claim for the relief of Rs.86.86 lakhs made by the assessee on the basis of export profit determined by it at Rs.173.72 lakhs on pro-rata basis of total export turnover to total turn over of the entire business. It was found in audit that during the relevant previous year, the assessee company operated one 100 percent export oriented unit with seperate accounts maintained thereof and the export profit derived therefrom during that year amounted to Rs.18.31 lakhs qualifying for the relief towards export turnover. The export profit, qualifying for the relief, derived from the other units not coming under the ambit of 100 percent export unit amounted to Rs.23.13

lakhs on pro-rata basis. As the total amount of export profit came to Rs.41.44 lakhs only (Rs.18.31 lakhs plus Rs.23.13 lakhs), the assessee company was entitled to a deduction of Rs.20.72 lakhs under the provisions as against Rs.85 lakhs actually allowed in the assessment. The allowance of excess deduction resulted in under-assessment of total income by Rs.64.28 lakhs involving undercharge of tax of Rs.32.73 lakhs for the assessment year 1986-87.

(iv) In another case deduction u/s 80HHC was not reduced consequent upon the reduction in export profit in subsequent revisions resulting in excess allowance of deduction of Rs.29.80 lakhs with consequent short levy of tax of Rs.7 lakhs in three assessment years 1986-87 to 1988-89.

Bombay charge

(i) 12 assessees claimed the deduction of Rs.474.81 lakhs for assessment years 1985-86 to 1989-90 under Section 80-HHC, but the business carried on by them did not exclusively consist of export out of India and thus deduction was required to be restricted proportionately. Omission to do so resulted in excess deduction aggregating to Rs.25.31 lakhs involving total short levy of tax of Rs.16.65 lakhs.

Assam charge

Under the Income-tax rules, 1962 only 40 percent of the income derived from sale of tea grown and manufactured by a seller in India is liable to income-tax. It was judicially held* that deduction under Chapter VIA of the Act are to be allowed in full before apportionment of income under Income-tax Rules, 1962.

(i) In the case of six tea companies, for the assessment years 1986-87 and 1987-88, the assessments for which were completed between March 1989 and March 1991, the assessing

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*** Commissioner of Agricultural Income-tax, Madras and another Vs. Periakaramalai Tea and Produce Co. Ltd. and others (84-ITR-643)**

officers allowed deductions amounting to Rs.484 lakhs on export turnover calculating the relief in respect of export turnover from 40 percent of business income liable to income tax, instead of from 100 per cent composite income. The erroneous deduction resulted in under assessment of income aggregating to Rs.290.40 lakhs involving tax effect of Rs.160.19 lakhs (including interest).

(ii) In the case of another tea company for the assessment year 1985-86, similar mistake in allowing deduction of Rs.16.60 lakhs from 40 percent of income liable to tax instead from 100 percent of income, resulted in underassessment of taxable income by Rs.9.64 lakhs involving undercharge of tax of Rs.8.63 lakhs (including interest of Rs.3.06 lakhs for short payment of advance tax).

Omission to deduct income not attributable to export business from business income

2.03.10 According to the provisions of Section 80-HHC of the Income-tax Act, 1961, only business income derived from the export of goods or merchandise qualifies for deduction and thus income not derived from the export of goods is required to be excluded while arriving at business income.

Tamil Nadu charge

In three cases, miscellaneous income and commission which were not derived from the business of export of goods were included in the profit and loss account and business income computed for the assessment years 1986-87 to 1987-88. This resulted in incorrect grant of deduction aggregating to Rs.7.34 lakhs involving tax effect of Rs.4.79 lakhs, including interest of Rs.31,680.

West Bengal charge

(i) In the case of a company, the non deduction of freight and insurance charges from gross export sales resulted in excess allowance of deduction under Section 80-HHC to the tune of Rs.10.88 lakhs with consequent

tax effect of Rs.5.71 lakhs in the assessment year 1986-87.

(ii) In the revised assessments for the assessment years 1986-87 and 1987-88 of a registered firm completed in June 1990 and November 1989 the total incomes were reduced to Rs.11.26 lakhs and Rs.8.44 lakhs respectively. The deduction on account of export out of India were allowed to the extent of Rs.9.87 lakhs and Rs.13.13 lakhs respectively. The assessee carried on business of export out of India of hosiery goods, commission sale of commodities and also had interest income from non-business ivnestments. The allowable deduction would, therefore, be based on the export profit only which stood included in the business income of the assessee and no other income. The business income of the assessee was Rs.11.91 lakhs for assessment year 1986-87 and Rs.11.29 for assessment year 1987-88 and the proportion of export turnover to total turnover was 49.47 percent and 66.10 percent respectively. The business profit eligible for deduction for assessment year 1986-87 would, therefore be Rs.5.89 lakhs (i.e. 49.47 percent of Rs.11.91 lakhs). Thus, the deduction should have been limited to Rs.2.95 lakhs being 50 percent of Rs.5.89 lakhs instead of Rs.9.88 lakhs allowed by the assessing officer which resulted in excess allowance of Rs.6.93 lakhs. Similarly, the deduction allowable for assessment year 1987-88 would be Rs.6.53 lakhs (i.e. 4 percent of foreign exchange realisation of Rs.5.60 lakhs plus 50 percent of the difference between export profit and 4 percent of foreign exchange realisation Rs.0.93 lakhs) but the assessing officer allowed Rs.13.13 lakhs which resulted in excess allowance of Rs.6.60 lakhs. This resulted in the aggregate undercharge of income by Rs.13.53 lakhs involving a tax effect of Rs.3.04 lakhs for both the years. This has a consequential effect also of short levy of interest for short payment of advance tax by Rs.84,240 for both the years and for belated submission of return amounted to Rs.3,607 for assessment year 1987-88

The department has accepted the audit observation.

Karnataka charge

In respect of one case of a private limited company, interest on `Bank deposit' aggregating to Rs.317.09 lakhs for the assessment years 1987-88 to 1989-90 was incorrectly taken into account while calculating the deduction under section 80-HHC. Had the interest income been excluded, the assessee`s business income would have been negative rendering him ineligible for deduction towards export. The incorrect deduction resulted in under assessment of income involving short levy of tax of Rs.91.45 lakhs for the three years 1987-88 to 1989-90(excluding short levy of interest for short payment of advance tax). Further additional tax of Rs.12.57 lakhs was also leviable for assessment year 1989-90.

Punjab charge

While completing the assessments of an assessee firm for the assessment years 1987-88, 1988-89 and 1989-90 in March 1989, October 1989 and December 1989 respectively, the assessing officer allowed deduction after taking into account the amount of lease rent of Rs.6 lakhs received in each of the aforesaid assessment years. Though lease rent is part of the business income, it cannot be treated as part of export turnover and the profits derived by the assessee from the export of goods or merchandise. The mistake resulted in underassessment of income of Rs.4 lakhs, Rs.4.53 lakhs and Rs.6 lakhs for the assessment years 1987-88, 1988-89 and 1989-90 respectively involving short levy of tax aggregating to Rs.8.42 lakhs.

Delhi charge

In respect of four assessees (an individual, a firm and two companies) income from commission and interest were included as business income for calculating the deduction under section 80-HHC resulting in excess deduction of Rs.5.80 lakhs involving

undercharge of tax of Rs.3.44 lakhs for assessment years 1986-87 to 1988-89 and 1990-91.

Omission to deduct allowance under Section 32A/32AB while arriving at business income for computation of proportionate export profit.

2.03.11 Allowance of deduction under section 80-HHC is on the business income relatable to export of goods. The business income referred to is profits and gains from `business or profession' computed with reference to sections 28 to 44 of the Income-tax Act.

Tamil Nadu charge

Business income is computed under the Act after deducting from the gross income expenses incurred for the purpose of business and allowances such as depreciation, investment allowance or investment deposit, etc.

In the case of three assessees, the export profit was computed for the assessment years 1986-87 to 1988-89 on business income as computed before allowance of deduction under section 32A and 32 AB towards investment allowance or investment deposit aggregating to Rs.5.24 lakhs. The mistake resulted in undercharge of tax of Rs.3.07 lakhs including tax in the hands of partners.

Assam charge

In the case of a tea company, in respect of which the assessment for the assessment year 1986-87 was completed in March 1989, deduction of investment allowance was incorrectly made after applying Rule 8 of the Income-tax Rules, 1962, i.e. from 40 percent business income liable to income tax. After correctly allowing the deduction of Investment allowance before applying Rule 8, the export profit in the case would work out to Rs.2.39 lakhs. The allowable deduction in respect of export turnover, therefore, worked out to Rs.1.20 lakhs (50 per cent of Rs.2.39

lakhs) which in the case of tea company would work out to Rs.0.48 lakhs (40 per cent of Rs.1.20 lakhs). Instead the assessee claimed Rs.2.02 lakhs on the basis of reserve created which was allowed as such by assessing officer.

Erroneous allowance of excess deduction of investment allowance of Rs.6.89 lakhs (60 percent of Rs.11.48 lakhs) and excess deduction of relief in respect of export turnover of Rs.1.54 lakhs (Rs.2.02 lakhs minus Rs.0.48 lakh).resulted in under assessment of income of Rs.8.43 lakhs with consequent under charge of tax and interest of Rs.5.45 lakhs.

West Bengal charge

(i) In respect of three companies, the business profit for the assessment years 1986-87 and 1987-88 was arrived at without taking into consideration the deduction allowed by way of investment allowance resulting in excess deduction of an amount aggregating to Rs.18.57 lakhs with tax effect of Rs.10.40 lakhs, including potential tax effect of Rs.8.34 lakhs in one case.

(ii) The assessment of the assessee, a registered firm for the assessment year 1988-89 was made in August 1989 and subsequently revised in November 1989 and May 1990. The deduction allowed for export against the revised income of Rs.35.27 lakhs (November 1989) was Rs.16.94 lakhs. Subsequently, the revision of May 1990 reduced the income to Rs.13.84 lakhs but the aforesaid deduction remained at Rs.16.93 lakhs and the department did not reduce and restrict the deduction in the context of the reduced income of Rs.13.84 lakhs. Further, the assessee's income was not exclusively from export business. The total income of Rs.13.84 lakhs comprised of business income of Rs.1.02 lakhs and other source income of Rs.12.82 lakhs. The proportionate export profit would be Rs.65,692 (64.34 percent of Rs.1.02 lakhs proportionately) worked out on the basis of export turnover of Rs.2.01 crores and total turnover of Rs.3.12 crores. There was,

therefore, excess deduction and underassessment of Rs.16.28 lakhs (allowed 16.93 lakhs, allowable 65,692 i.e. limited to export profit). The undercharge would be Rs.3.95 lakhs.

The department has accepted the audit observation.

Gujarat charge

In two cases, the assessees claimed deductions aggregating to Rs.6.12 lakhs for assessment years 1985-86 to 1988-89 in respect of export profits. The deductions were allowed by the department ignoring the amounts of carried forward losses, unabsorbed depreciation and unavailed investment allowance etc. of previous years. This resulted in aggregate short levy of tax of Rs.3.49 lakhs.

Rajasthan charge

In the case of an assessee, omission to deduct unabsorbed investment allowance while working out the correct amount of proportionate export profit resulted in underassessment of income of Rs.17.32 lakhs involving short levy of tax of Rs.8.89 lakhs in the assessment years 1986-87 and 1987-88.

Delhi charge

The total income of a public limited company, engaged in the fabrication and export of fabrics, for the assessment year 1989-90 was determined at Rs.49.40 lakhs after allowing deduction of Rs.28.78 lakhs towards export turnover under Section 80-HHC from gross total income of Rs.78.17 lakhs which was arrived at without set off of brought forward business loss of earlier years amounting to Rs.692.98 lakhs. This was on the plea that the brought forward losses were provisional though the losses were determined in the revised assessment framed for the assessment year 1984-85 on 31 January 1990 on which date the assessment for the assessment year 1989-90 was also completed. The incorrect allowance of deduction resulted in excess

computation and carry forward of loss of Rs.28.78 lakhs involving potential tax effect of Rs.15.11 lakhs.

Omission to restrict deduction under section 80 HHC to the amount of reserve created.

2.03.12 For claiming deduction under Section 80 HHC, from assessment year 1986-87 to 1988-89, the assessee is required to create a reserve by debiting profit and loss account and crediting reserve account by an amount equal to the amount of deduction. Thus, where the reserve created falls short of the amount of deduction to which the assessee is eligible, the deduction allowed is to be restricted to the amount of reserve created.

Tamil Nadu charge

In three cases, for the assessment years 1987-88 and 1988-89, omission to restrict deduction to the reserve created resulted in excess allowance of relief aggregating to Rs.6.96 lakhs involving tax effect of Rs.3.57 lakhs.

Assam charge

In the case of 3 tea companies, for the assessment years 1986-87 and 1987-88, assessments for which were completed during November 1990 to March 1991, deductions aggregating to Rs.153.10 lakhs were claimed and allowed by the assessing officer, though the assessees had created the reserves of Rs.75.15 lakhs in all. The omission to restrict the deduction to the amount of reserve created resulted in excess deduction of Rs.78.74 lakhs resulting in under assessment of income aggregating to Rs.31.34 lakhs (being 40 percent of Rs.78.74 lakhs) involving short levy of tax of Rs.16.21 lakhs.

West Bengal charge

(i) In respect of four cases, the omission to restrict the deduction to the amount of reserve created for the assessment years

1986-87 to 1988-89 resulted in excess allowance of deduction of Rs.6.51 lakhs involving tax effect of Rs.3.85 lakhs.

(ii) Similarly in another case, export incentive deduction of Rs.1.46 crores was allowed for assessment year 1988-89 though no export incentive reserve was created. This resulted in undercharge of tax of Rs.84.55 lakhs.

(iii) In yet another case, deduction of Rs.11.76 lakhs was allowed in the assessment year 1986-87, being 50 percent of the profits earned in export business against Rs.5.64 lakhs actually debited to the relevant profit and loss account for creation of export profit reserve account. The incorrect deduction allowed over and above the deduction admissible as per law, led to short levy of tax of Rs.3.21 lakhs.

Ministry of Finance have accepted the audit observation.

Madhya Pradesh charge

In the case of a company, the assessing officer, while making assessment (March 1990) for the assessment year 1987-88 at Rs.1.05 crores, allowed carry forward of unabsorbed deduction of Rs.31.12 lakhs. As the income was assessed by applying the provisions of section 80-VVA and the assessee had credited Rs.5 lakhs only to the "Export development reserve account", the carry forward of unabsorbed deduction to the extent of Rs.5 lakhs only was allowable. The excess carry forward of unabsorbed deduction of Rs.26.12 lakhs had led to potential short levy of tax of Rs.13.06 lakhs.

Ministry of Finance have accepted the audit observation.

Bombay Charge

Three assessee companies were allowed deductions of Rs.36.95 lakhs, Rs.18.72 lakhs and Rs.74.75 lakhs respectively under Section 80-HHC for assessment year 1987-88 whereas

the reserves created in the profit and loss account were Rs.26.50 lakhs, Rs.8.50 lakhs and Rs 26.45 lakhs only. Omission to restrict the claim to the amounts of reserve created resulted in under assessment of income aggregating to RS.68.97 lakhs with tax effect of Rs 49.77 lakhs.

Orissa charge

In the case of an unregistered firm and a closely held company, deduction under Section 80-HHC amounting to Rs.9.60 lakhs for assessment years 1986-87 and 1987-88 was allowed whereas the assessee had neither created a reserve nor filed the report of the Chartered Accountant, resulting in undercharge of tax of Rs.4.81 lakhs.

Incorrect grant of relief for export of merchandise/ goods not qualifying for the relief.

2.03.13 According to the provisions of the Income-tax Act 1961, only export of goods/merchandise other than mineral oil, minerals and ores qualify for deduction under section 80HHC.

Rajasthan charge

In the case of a company and a registered firm engaged in the business of minerals, (excavating and selling minerals known as Calcite and Wollastonite and export of fabricated Mica, Mica powder and Mica scrap), incorrect grant of deduction for the assessment years 1986-87 to 1989-90 aggregating to Rs.66.92 lakhs resulted in undercharge of tax of Rs.39.74 lakhs in two cases.

Omission to offer cash incentive received for taxation

2.03.14 In view of the retrospective insertion of clauses (iiia) (iiib) & (iiic) to section 28, duty drawback, cash compensatory support and profits on sale of import entitlements are to be included under

the head "Profits and gains of business or profession".

Tamil Nadu charge

In respect of seven cases while computing the taxable income for the assessment years 1986-87 to 1989-90, the assessees did not offer the amounts received as cash assistance/cash compensatory support aggregating to Rs.78.95 lakhs for taxation. The assessing authorities too failed to bring these amounts to tax which resulted in under charge of tax of Rs.14.72 lakhs (including potential tax effect of Rs.50,000).

Assam charge

In respect of 5 tea companies, for the assessment years 1986-87 to 1989-90, refund of duty draw back, income from interest and cash compensatory support aggregating to Rs.243.69 lakhs were received. It was noticed that 40 percent of the above income was allocated as business income on the analogy of Rule 8 of the income-tax Rules 1962 instead of treating the amounts as income from other sources, subject to full tax liability. The mistakes resulted in under-assessment of Rs.142.18 lakhs leading to short levy of tax of Rs.84.20 lakhs.

Madhya Pardesh charge

In the case of 26 assessees, receipts on account of profit on sale of import entitlement licences, cash assistance, duty drawback, etc., amounting to Rs.434.02 lakhs were either not offered for taxation or lesser amounts were offered in the assessment years 1986-87 to 1988-89, and the same were not brought to tax. The omission resulted in undercharge of tax of Rs.212.35 lakhs.

Delhi charge

An assessee claimed exemption of cash assistance of Rs.23.99 lakhs out of Rs.33.16 lakhs in view of I.T.A.T's Delhi Special Bench decision in the case of M/s.Gadore tools Pvt. Ltd. which was allowed to the

extent of Rs.11.41 lakhs determining the income at `Nil' for the assessment year 1988-89. Irregular exemption resulted in underassessment of income of Rs.11.41 lakhs with short levy of tax of Rs.7.80 lakhs (including interest of Rs.63,000)

Defaults in compliance with statutory requirements/ provisions

Omission to file Form 10CCAB and 10CCAC

2.03.15 From the assessment year 1987-88 and as amended by the Finance Act 1987, the deduction under Section 80-HHC shall not be allowed unless the assessee furnishes with the return of income the report of an Accountant certifying that the deduction has been correctly claimed on the basis of net foreign exchange realisation.

Tamil Nadu charge

In four cases, omission to disallow deductions aggregating to Rs.61.89 lakhs for the assessment years 1987-88 and 1989-90 for default of the assessee in complying with the above provision resulted in under-charge of tax of Rs.8.82 lakhs and potential tax effect of Rs.21.94 lakhs.

West Bengal charge

In respect of two companies, deduction under Section 80-HHC for the assessment years 1987-88 and 1989-90 was allowed though the assessees did not furnish report of an Accountant in the prescribed form. The incorrect grant of deduction resulted in total under assessment of Rs.16.95 lakhs with consequent tax effect of Rs.10.94 lakhs in aggregate.

Madhya Pradesh charge

In the case of a company, deduction amounting to Rs.8.16 lakhs involving tax effect of Rs.4.08 lakhs was allowed for the assessment year 1987-88, though the report of the Accountant in the prescribed form was not filed alongwith the return.

Gujarat charge

In respect of six assessees, deductions aggregating to Rs.15.31 lakhs were allowed during assessment years 1987-88 to 1989-90 although the returns were not supported by the report in Form 10 CCAB. This resulted in aggregate short levy of tax of Rs.8.52 lakhs.

Bombay charge

In the case of two assessees, deduction under Section 80-HHC aggregating to Rs.16.26 lakhs was allowed for the assessment year 1988-89 though the asssessees had not furnished the report by the Accountant in the prescribed form resulting in short levy of tax of Rs.10.16 lakhs.

Uttar Pradesh charge

(i) Two assessee companies were allowed deduction under section 80-HHC of an amount aggregating to Rs.114.18 lakhs while computing their income under Section 115J for the assessment year 1989-90 whereas according to the certificate of the Chartered Accountant, the admissible deduction was Rs.72.41 lakhs only. This resulted in excess deduction of Rs.16.87 lakhs involving short levy of tax of Rs.7.22 lakhs.

(ii) Further, in four cases in respect of three firms and a company, the deductions under Sec.80HHC amounting to Rs.13.96 lakhs for the assessment year 1987-88 were allowed but the returns of income were not accompanied by the requisite report of the Accountant, resulting in total undercharge of tax of Rs.4.34 lakhs.

2.03.16 For the purpose of Section 80-HHC of the Income-tax Act, 1961, `export turnover' is defined as the sale proceeds receivable by the assessee in convertible foreign exchange.

Bombay charge

(i) In the case of two assessees, deduction under Sec.80-HHC aggregating to Rs.9.11 lakhs

was allowed on the income received by them by way of sales of service or commission for the assessment years 1987-88 and 1988-89 which did not bring foreign exchange in India. The irregular deduction involved short levy of tax of Rs.5.93 lakhs in two cases.

(ii) In another case in the same charge, deduction was allowed for an amount of Rs.2.76 lakhs in the assessment year 1985-86, though the sale proceeds of the goods exported were not received by the assessee in convertible foreign exchange resulting in short levy of tax of Rs.2.75 lakhs {including interest under Section 139(8) and 215)

(iii) In two other cases of an Indian company and a registered firm, free on board value was taken at Rs.612.40 lakhs and Rs.7364.61 lakhs as against Rs.491.36 lakhs and Rs.7126.19 lakhs actually realised in convertible foreign exchange as shown in the profit and loss account in the assessment year 1987-88. The incorrect deduction resulted in under assessment of income aggregating to Rs.10.35 lakhs involving short levy of tax of Rs.6.05 lakhs.

Rajasthan charge

In the case of 6 registered firms engaged in the business of jems and jewellery, deductions aggregating to Rs.59.78 lakhs were allowed for the assessment years 1986-87 to 1989-90 as profits derived out of export sales. However the goods were not exported out of India but sold in the assessees' show rooms against convertible foreign exchange. The irregular deduction resulted in short levy of tax aggregating to Rs.40.84 lakhs.

Delhi charge

(i) In the assessments for the assessment years 1984-85 and 1985-86 three assessee companies, engaged in the business of export, were allowed deduction of Rs.14.59 lakhs on the export turnover. The deduction was allowed out of the gross total income of Rs.23.17 lakhs which included receipts aggregating to Rs.128.21 lakhs on account of

cash incentive, duty draw backs,etc. As the income after exclusion of these receipts which could not be considered as income derived from the export of eligible goods was negative and also these were not receivable in convertible foreign exchange, deduction in respect of export turnover was not admissible. The mistake resulted in underassessment of income of Rs.14.59 lakhs with consequential undercharge of tax of Rs.11.79 lakhs (including interest).

(ii) In the assessment for the year 1985-86 an assessee a private limited company, engaged in the business of export was allowed deduction of Rs.5.82 lakhs on the export turnover. The deduction was allowed out of the gross total income of Rs.8.74 lakhs which included receipts aggregating to Rs.7.62 lakhs on account of duty drawback, cash incentive and furnishing receipts. As the income of the specified nature after exclusion of income on account of duty drawback, cash incentive and furnishing receipts included in the gross total income was Rs.1.12 lakhs, the deduction should have been restricted to this extent. The incorrect allowance resulted in underassessment of income of Rs.4.70 lakhs with undercharge of tax of Rs.3.77 lakhs (including interest of Rs.17,500 and Rs.63,000 leviable under Section 139(8) and 215 of the Act respectively).

Karnataka charge

In the case of a private limited company for the assessment years 1987-88 to 1989-90 deductions aggregating to Rs.146.87 lakhs was allowed in respect of export profits which included interest income from the term deposits (made in India out of money received from the intending foreign buyers) amounting to Rs.317.10 lakhs in the above years. If interest income which did not represent sale proceeds of goods exported etc. received in convertible foreign exchange, is excluded, assessees export profits would be `Nil' and will not be entitled to the deduction. The incorrect allowance of deduction resulted in underassessment of income aggregating to

Rs.146.88 lakhs involving undercharge of tax of Rs.91.45 lakhs for the three years 1987-88 to 1989-90 (excluding short levy of interest for short payment of advance tax). Further additional tax of Rs.12.57 lakhs was also leviable for assessment year 1989-90.

2.03.17 Under the provisions of Section 80 HHC as applicable upto 31 March 1989, tax payers who export goods or merchandise direct were eligible for the incentive.The benefit was not directly available to supporting manufactuers who exported goods through Export or Trading Houses.

Kerala charge

In the case of 3 assessee (firms), the deduction under Section 80-HHC for assessment years 1987-88 to 1988-89 was allowed on the aggregate value of direct export and export through Export Houses resulting in excess deduction aggregating to Rs.12.56 lakhs involving tax effect of Rs.3.48 lakhs.

2.03.18 In terms of the first proviso to sub section 1 of Section 80-HHC, the deduction under that sub section shall not exceed the profits derived by the assessee from the export of goods or merchandise.

Kerala charge

In the case of a firm and a company, deduction under Sec.80-HHC for the assessment year 1987-88 was allowed at Rs.35.22 lakhs whereas the profit derived by the assessees from export was only Rs.26.97 lakhs. The incorrect deduction resulted in under assessment of income of Rs.8.25 lakhs involving tax effect of Rs.2.51 lakhs.

West Bengal charge

In the case of an assessee for the assessment year 1986-87, incorrect deduction of Rs.48.09 lakhs was allowed though the total business income was assessed at loss resulting in undercharge of tax of Rs.25.25 lakhs.

Madhya Pradesh charge

In the case of 4 assessee companies, deduction aggregating to Rs.12.17 lakhs involving short levy of tax of Rs.6.99 lakhs was allowed during the assessment years 1986-87 to 1988-89, though there was no positive income entitling the assessee for the relief.

Tamil Nadu charge

The assessment of a closely held company for the assessment year 1987-88 was completed by the Deputy Commissioner of Income-tax (Special Range) in March 1990, allowing a deduction of Rs.7.40 lakhs towards relief in respect of export turnover as against Rs.17.31 lakhs claimed by the assessee. Audit scrutiny in June 1990 revealed that although 4 percent of net foreign exchange realised through export business worked out to Rs.17.31 lakhs, the net profit earned through export business was Rs.3.26 lakhs only. Further the company had not created any reserve during the relevant previous year. As the company had not fulfilled the essential condition for the grant of deduction, no relief was admissible in respect of export turnover. The incorrect deduction led to short levy of tax of Rs.5.85 lakhs.

Ministry of Finance have accepted the audit observation.

Withdrawal from Reserve Account

2.03.19 In respect of assessment years 1986-87 to 1988-89, the assesses claiming deduction under section 80-HHC were required to create a reserve to be utilised for the purpose of business.

Bombay charge

Ten assessees had withdrawn the export profit reserve of Rs.122.10 lakhs and credited the same to Partner's capital account in the assessment year 1989-90. The amount involved tax of Rs.34.14 lakhs.

2.04 MISTAKE IN ASSESSMENTS COMPLETED UNDER THE SUMMARY ASSESSMENT SCHEME

2.04.1. With a view to speeding up the completion of regular assessments and to save time for more intensive scrutiny of very important cases for detection of possible concealment of income, the Income tax Act provided for summary assessment of cases on the basis of income or loss returned subject to prescribed adjustments, where the correctness and completeness of the return are not in doubt. Consistent with the policy of reposing trust on tax payers in the generality of cases, Government determined from time to time the cases to be finalised under the procedure.

2.04.2 In the Audit Report for the year ended 31 March, 1987 a detailed review of the procedure of summary assessment was incorporated highlighting irregularities of diverse nature noticed in the application of the law and procedure and relating to built-in control in the procedure, including random sample scrutiny, with a view to ensuring that the procedure was not abused. Similar irregularities were reported in para 4.41 and para 2.03 of the Audit Reports for the years ended 31 March 1988 and 31 March 1989 respectively. A separate Audit Report for the year ended 31 March 1990 on a review of the summary assessment procedure as applicable from assessment year 1988-89 under the caption `Central Action Plan (Income-tax) 1988-89' was also presented.

2.04.3 According to the Action Plan for 1988-89 of the Income-tax department, the summary assessment scheme was extended to all income groups irrespective of the size of income or loss returned and in every income group only a small percentage working to an overall 3 per cent was subjected to scrutiny. With this, the limited random sample scrutiny to act as a check on abuse of the scheme was dispensed with. The Public Accounts Committee, had in their 173rd Report(8th Lok Sabha), recommended in August 1989 that the extent of coverage under scrutiny assessment scheme should be

substantially increased pending a study on the effectiveness of the summary assessment procedure as recommended by them. The existing instructions regarding selective scrutiny, however, remained operative during the year under audit.

2.04.4 Mistakes noticed in the audit of summary assessments during the year 1990-91 grouped under four categories are given below:

	No.	Amount (In lakhs of rupees)
(i) Arithmetical errors in returns, accounts and documents and prima facie inadmissible expenses allowed	707	1,244.77
(ii) Omission to disallow deductions, allowances or reliefs prima facie inadmissible but claimed in the returns and allowed.	693	3,356.77
(iii) Irregular set off and carry forward and set off of unabsorbed losses, depreciation etc., and other reliefs	791	946.53
(iv) Other irregularities	3947	8,379.82
	@6138	13,927.89

@Does not include information in respect of Andhra Pradesh.

2.04.5 For the Audit Report for the year ended 31 March 1991, 509 draft paragraphs involving tax effect of Rs.7,249.59 lakhs in respect of assessments completed under the summary assessment scheme were sent to the Ministry of Finance for comments. 52 representative cases involving tax effect of

Rs.5,329.94 lakhs (including potential) are detailed below:

(a) Cases covered by prescribed adjustments, viz., arithmetical errors in returns, accounts and documents, mistakes in carry forward of unabsorbed allowances and *prima facie*, inadmissible expenses allowed (the last from assessment year 1989-90).

S.No.	Circle/ Assessee/ Assessment year	Nature of objection	Revenue effect (In lakhs of rupees)
(1)	Madhya Pradesh Company 1989-90	Income-tax on total income of Rs.44.17 lakhs was computed at Rs.16.58 lakhs as against correct amount of Rs.25.51 lakhs, interest for non payment of advance tax short paid by Rs.2.10 lakhs and additional income tax levied on additions made to returned income at Rs.1.47 lakhs instead of correct amount of Rs.3.96 lakhs.	13.52
(2)	West Bengal Company 1989-90	Loss was inadvertantly assessed by the assessing officer at Rs.318.24 lakhs (as shown in the revised return) as against the correct amount of Rs.299.42 lakhs computed by the assessee in a separate sheet enclosed with the revised return.	10.87 (Potential)
(3)	Maharashtra Company 1989-90	Allowance of Rs.198.80 lakhs as deduction in respect of profits and gains of new industrial undertakings established after 31 March 1981 as against admissible amount of Rs.44.63 lakhs (25 per cent of Rs.178.51 lakhs, the gross total income) after setting of unabsorbed depreciation and investment allowance.	97.13 (including additional tax of Rs.16.18 lakhs leviable)
(4)	Maharashtra Company 1986-87 to 1988-89	Brought forward losses of earlier years were erroneously included in the current years' losses or 'NIL' income returned by the assessee instead of setting off against the business income of relevant years resulting in irregular computation of loss aggregating to Rs.89.99 lakhs.	51.18 (Potential)
(5)	West Bengal Company 1987-88	While completing assessment (1) 40 per cent of Rs.23.90 lakhs was worked out at Rs.0.96 lakhs instead of Rs.9.56 lakhs (2) carried forward loss from assessment years 1985-86 and 1986-87 was taken at	36.05 (Potential)

		Rs.77.82 lakhs instead of the correct assessed losses of Rs.17.61 lakhs and (3) unpaid statutory liability debited to account amounting to Rs.8.19 lakhs was not added back to income leading to under-assessment of Rs.3.27 lakhs(40 per cent of Rs.8.19 lakhs as assessee was engaged in the business of manufacturing tea). These led to aggregate under-assessment i.e. excess carry forward of loss of Rs.77.09 lakhs.	
(6)	Maharashtra Company 1989-90	Disallowance of Rs.30.90 lakhs instead of Rs.93.74 lakhs expended on presentation articles costing more that Rs.50 in each case though information was available in the tax audit report accompanying the return.	39.59 (Potential) (including additional tax of Rs.6.60 lakhs leviable)
(7)	Maharashtra Company 1988-89	Tax was levied at the rate of 50 per cent leviable on a company in which public are substantially interested instead of correct rate of 60 percent applicable to an investment company in which public are not substantially interested as was applied in the assessment years 1984-85 onwards.	9.99
(8)	Karnataka Co-operative Society 1988-89	Incorrect acceptance of unabsorbed losses of Rs.3.85 crores for assessment years 1979-80 to 1981-82, 1983-84 and 1984-85 for non-filing of returns, for assessment year 1982-83 due to specific mentionin the assessment concluded in November 1984 and for assessment years 1985-86 and 1986-87 for filing returns after due dates.	161.61 (Potential)
(9)	Gujarat Co-operative Society 1988-89	Allowance of irregular carry forward and set off unabsorbed business loss of Rs.99.94 lakhs pertaining to the period prior to assessment year 1980-81 i.e. beyond the prescribed limit of 8 years for carry forward of business loss.	52.47 (Potential)
(10)	Maharashtra Co-operative Society 1989-90	Against total income of Rs.1.44 crores arrived at by the assessing officer for assessment year 1989-90 unabsorbed loss of Rs.7.46 crores instead of correct amount of unabsorbed depreciation of Rs.1.07 crores for assessment year 1988-89 was allowed.	15.59 and 268.53 (Potential)
(11)	Bihar	Incorrect carry forward of loss of	30.67

	Company 1987-88	Rs..58.43 lakhs in the nature of pre-operative expenses as no commercial production had started though it was disallowed for assessment years 1985-86 and 1986-87.	(Potential)
(12)	Gujarat company 1989-90	Allowance for set off of Rs.117.05 lakhs out of Rs.252.45 lakhs being carried forward unabsorbed depreciation and investment allowance when correct figure for such carried forward allowances was Rs.102.20 lakhs only.	78.88 (Potential)
(13)	Maharashtra Company 1988-89	Allowance for set off of Rs.409.58 lakhs as unabsorbed depreciation allowance as against correct amount of Rs.96.95 lakhs.	164.13
(14)	Maharashtra Company (16 companies) 1989-90	Excess allowance of Rs.1082.45 lakhs to be carried forward as unabsorbed business loss, depreciation and/or investmant allowance pertaining to earlier years by merging it in the current years amount of Rs.753.07 lakhs on the accounts bringing the total figure to be carried forward as Rs.1835.42 lakhs.	610.01 (Potential)
(15)	Andhra Pradesh Company 1988-89	Loss of Rs.58.63 lakhs as against correct amount of Rs.20.37 lakhs allowed for carry forward in the earlier assessment year 1987-88 was adjusted against current years' income of Rs.4.96 lakhs resulting in excess computation of loss by Rs.38.26 lakhs.	22.10 (Potential)
(16)	Madhya Pradesh Company 1988-89	Carry forward of loss of Rs.53.89 lakhs shown in the return signed by a director though Board of Directors was headed by a managing director was allowed while in the assessments of two immediately preceeding years such loss was disallowed.	31.12 (Potential)
(17)	Bihar Company 1989-90	Though the return due on 31 March 1989 was filed on 24 January 1990 business loss of Rs.49.79 lakhs was erroneously allowed to be carried forward.	26.14 (Potential)
(18)	West Bengal Company 1986-87 to 1988-89	Carried forward business losses of Rs.224.02 lakhs and Rs.289.51 lakhs of assessment years 1986-87 and 1987-88 respectively were erroneously allowed as returns of these years were submitted well beyond the due dates and no extention was allowed for the purpose.	269.60 (Potential)

(19)	Karnataka Company 1987-88	Carry forward of business loss of assessment year 1978-79 amounting to Rs.95.87 lakhs was erroneously allowed in the assessment beyond 8 years.	50.33 (Potential)
(20)	Uttar Pradesh Company 1989-90	Carry forward and adjustment of business loss to the extent of Rs.139.34 lakhs on account of unabsorbed investment allowance in the absence of any investment allowance reserve in respect of earlier years excent Rs.0.65 lakhs for the current assessment year 1989-90.	87.78
(21)	Maharashtra Company 1989-90	Allowance of Rs.485.85 lakhs as deduction for the provision made in the accounts for payment of customs duty in respect of imported material lying in the custom bonded warehouses and the Central Excise duty payable on uncleared finished goods which were not paid before filing the return.	306.08 (Potential) (including additional tax of Rs.51.01 lakhs leviable)
(22)	Maharashtra Non-resident banking company 1989-90	Allowance of Rs.174.43 lakhs as deduction which as per tax audit report of the foreign bank accompanying the report was a contigent liability on account of expected liability for the banks obligation towards guarantees and acceptance in respect of a private cotton mills.	136.06 (including additional tax of Rs.22.68 lakhs leviable)
(23)	Maharashtra Company 1988-89 1989-90	In the case of two assessees, cash compensatory support of Rs.46.24 lakhs and Rs.96.84 lakhs was allowed as deduction as claimed and was not brought to tax.	29.14(Potential) (including addl. tax leviable) and Rs.61.01 lakhs.
(24)	Maharashtra Company 1989-90	In the case of four companies, cash compensatory support of Rs.948.07 lakhs was allowed as deduction as claimed and was not taxed.	177.05 and 411.30(Potential) (including addl.tax leviable).
(b)	Cases not covered by prescribed adjustments		
(1)	Maharashtra Co-operative Society 1986-87 to 1988-89	Assessee's claim for deduction in respect of profit from newly established industrial undertaking though disallowed for assessment year 1985-86 was allowed though no new unit was started but only old unit was expanded and modernised.	36.27
(2)	West Bengal	Allowance of Rs.101.86 lakhs as deduction	56.02

	Company 1987-88	for payment of interest on loan from bank though not provided for in accounts. The liability therefore was disputed by the assessee.	(Potential)
(3)	West Bengal Company 1987-88	Allowance of Rs.67.34 lakhs as deduction on account of unpaid statutory liabilities relating to sales tax, employees state Insurance and provident fund.	33.67 (Potential)
(4)	Maharashtra Company 1988-89	Allowance of Rs.62 lakhs as deduction which was debited in Profit and Loss account on account of salaries and was classified in tax audit report accompanying the return as contigent expenditure.	39.06
(5)	Delhi Company 1986-87	Allowance of Rs.76.41 lakhs as deduction which was debited in Profit and Loss account on account of taxes, duties, and employees contribution to provident fund and family pension etc., but were not paid in the relevant previous year.	40.12 (Potential)
(6)	Gujarat company 1989-90	Allowance of depreciation allowance of Rs.370.97 lakhs for 21 months when production in the previous year ending 31 March 1989 started from 1 January 1989 only. According to assessee's declaration also the business came into existence from 1.1.1989.	110.18 (Potential) (including addl. tax of Rs.18.36 lakhs leviable)
(7)	West Bengal Company 1986-87 to 1988-89	Allowance of depreciation of Rs.9 lakhs Rs.26 lakhs and Rs.29.70 lakhs on plant and machinery when company was taken over by the Government of India with effect from 30.6.1984 and neither the audited accounts alongwith auditor's report nor the particulars of fixed assets taken over by the present management were furnished as required under the Act. Such allowance of Rs.24.52 lakhs was disallowed in the assessment for assessment year 1985-86.	33.32 (Potential)
(8)	West Bengal Company 1989-90	Allowance of investment allowance of Rs.82.63 lakhs, as claimed on plant and machinery acquired and put to use in the previous year ended 31 March 1987, though grant of investment allowance was discontinued with effect from 1.4.1987 under notification dated 12.6.1986 unless there was evidence that orders for acquiring	60.72 (including Rs.8.67 lakhs for short payment of advance tax and Rs.8.68 lakhs addl. tax leviable).

		them were placed before 12.6.1986 and these were acquired and put to use after 31 March 1987 but before 1 April 1988 which was not done.	
(9)	West Bengal company 1987-88	Allowance of Rs.60.35 lakhs as deduction, an amount debited in the Profit and Loss account as provision for doubtful debts.	30.42 (Potential)
(10)	Punjab Company 1986-87 to 1988-89	Allowance of Rs.16.33 lakhs, Rs.13.87 lakhs and Rs.33 lakhs as deduction towards earlier years expenses though the assessee was following mercantile system of accounting.	36.11 (Potential)
(11)	Maharashtra Company 1989-90	In closing stock, value of statutory levies (viz. Central excise and custom duties) amounting to Rs.58.55 lakhs was not included though details were available in the account accompanying the return and accounts were maintained on mercantile basis.	36.89 (including addl. tax of Rs.6.15 lakhs leviable)
(12)	West Bengal Company 1988-89	Non-disallowance of the undisclosed liability towards provident and family pension fund contribution, employees state insurance corporation, sales-tax and other statutory liabilities amounting to Rs.212.52 lakhs.	111.57 (Potential)
(13)	West Bengal Company 1989-90	Allowance of Rs.72.22 lakhs as deduction which as per tax audit report was a provision for interest payable on loans taken from public financial institutions. There was no evidence of such payment by the due date of submission of return.	37.92 (Potential)
(14)	West Bengal Company 1988-89	Allowance of Rs.521.26 lakhs as deduction, a provision made on account of contribution towards contributory provident funds as against on account payment of Rs.422.65 lakhs only.	51.77 (Potential)
(15)	Karnataka Company 1987-88	Due to change in the method of arriving at the cost, the value of work-in-progress and finished products was increased by Rs.7.71 crores as compared to the method adopted in earlier previous year. The assessee reduced the income ascertainable from accounts by Rs.7.71 crores. However, the value of opening stock adopted in the accounts of the following assessment year 1987-88 at the same figure of the closing stock of the assess-	405.00 (potential)

		ment year 1986-87 was, however, left undisturbed and taxable income of assessment year 1987-88 computed without making any adjustment. As a result income of Rs.7.71 crores escaped assessment altogether.	
16)	West Bengal Company 1986-87 to 1988-89	Allowance of Rs.24.93 lakhs, Rs.26.05 lakhs and Rs.29.20 lakhs as deduction shown in the accounts as interest on gifted material of Rs.192.05 lakhs from Government of Japan at bank overdraft rate.	41.44 (Potential)
17)	West Bengal Company 1986-87	Allowance of amounts debited in Profit and Loss account as deduction (1) Rs.2.42 crores for unpaid tax and duties etc., (2) Rs.16.13 lakhs in respect of capital expenditure (3) Rs.45,460 (net) of guest house expense and (4) Rs.1.13 crores for bad and doubtful debts which had not become actually bad and were written off.	195.20 (Potential)
18)	Tamil Nadu Company 1988-89	Allowance of entire profit of Rs.295.14 lakhs as per Profit and Loss account against amount of unabsorbed depreciation though there was no brought forward business loss and provision of Rs.37.09 lakhs for unascertained liabilities resulted in non-assessment of Rs.99.67 lakhs (30 per cent of Rs.332.23 lakhs as taxabale income was less than 30 percent of book profit) for income-tax.	72.17 (including interest of Rs.19.84 lakhs for non-filing of estimate)
19)	West Bengal Company, 1984-85, 1986-87 to 1988-89	Allowance of double taxation relief of Rs.25.61 lakhs when Indian income of the company was not taxable in Japan.	33.95 (including interest of Rs.1.10 lakhs for late filing of return and Rs.7.25 lakhs for non-payment of advance tax)
(20)	Maharashtra Company 1989-90	Allowance to increase unabsorbed depreciation and investment allowance for carrying forward by the amount of assessed income of Rs.91.35 lakhs arrived at under the restrictive provisions of section 115-J of the Act for the purpose of minimum taxation alone.	47.96 (Potential)
(21)	Maharashtra Company 1989-90	Allowance of investment allowance of Rs.43.91 lakhs to the assessee (not being a small scale industrial undewrtaking)	31.81 (including Rs.4.15 lakhs

		engaged in the manufacture of cosmetics, tooth paste, tooth powder etc., listed in Eleventh Schedule to the Act, information of which was available in the documents accompanying the return.	paid as interest on tax refunded and addl. tax of Rs.4.61 lakhs leviable).
(22)	Maharashtra Company 1988-89	Allowance of claim of the assessee as deduction Rs.90.73 lakhs being value of right to import raw material duty free under the Duty Exemption Scheme which was credited in Profit and Loss account but was not included in taxable income.	47.63 (potential)
(23)	Maharashtra company 1987-88	Provision made for payment of interest on Government loans for the period 1976-77 and earlier years was made and allowed in the relevant accounting years, Rs.9.30 crores was waived by the Government on account of such interest in the previous year relevant to assessment year 1987-88 but was not treated as income though credited in Profit and Loss Account.	465.00 (potential)
(24)	Assam Company 1983-84	The assessee who was maintaining account under mercantile system debited irregularly in profit and loss account Rs.7.01 lakhs as previous year's adjustment and accounted for Rs.48.66 lakhs as against actual receivable amount of Rs.78.23 lakhs as receipt on price variation claim.	27.81

Ministry of Finance have accepted the audit observation in respect of seven cases.

ANNEXURE A
STATE- WISE

	State/AG	No.of cases	Investment Allowance allowed carried forward	Revenue Forgone	Reserve created
1.	Andhra Pradesh	28	2472.57	1385.61	3814.56
2.	Assam	13	859.66	314.33	559.50
3.	Bihar	9	147.92	---	190.84
4.	Gujarat	11	12163.30	7257.88	9322.62
5.	Haryana	11	1429.12	786.40	837.31
6.	Haryana(UT)	8	37.54	22.97	37.12
7.	Himachal Pradesh	--	--	--	--
8.	Karnataka	21	7296.34	3089.84	5351.84
9.	Kerala	49	6743.14	3733.62	4095.40
10.	Madhya Pradesh	21	4561.05	2405.80	3420.40
11.	Orissa	17	423.08	157.54	112.22
12.	Punjab	24	1774.51	963.43	1356.52
13.	Rajasthan	12	1092.05	611.77	930.23
14.	Tamil Nadu	34	11484.04	6325.98	7949.32
15.	Uttar Pradesh	28	3974.00	2466.90	3854.10
16.	New Delhi	13	425.29	188.92	239.37
17.	Maharashtra	11	12514.64	6979.55	8102.15
18.	West Bengal	24	6659.28	3698.69	5251.64
19.	Jammu & Kashmir	--	--	--	--
	Total	334	74059.53	40389.23	55425.14

Fixed capital added for						(In lakhs of Rupees)
Replacement	Increased capacity	New Activity	Others including additions to land and building	New assets acquired	Total	Remarks
---	17256.59	---	---	---	17256.59	
---	---	---	---	6065.51	6065.51	
---	---	---	---	903.62	903.62	
---	65700.04	231.49	---	54282.08	120213.61	
3522.59	2628.32	491.77	---	4725.21	11367.89	
0.09	190.92	27.14	---	153.15	371.30	
---	---	---	---	---	---	Nil
---	1944.46	7991.17	430.50	53266.10	63632.23	
24473.79	565.76	69.06	---	1834.93	26943.54	
---	427.96	---	---	28505.54	28933.50	
---	---	---	---	795.18	795.18	
3315.46	1994.46	1671.86	---	8867.36	15849.14	
---	6079.23	---	---	9208.79	15288.02	
6898.02	52410.86	11873.07	---	71269.63	142451.58	
4053.62	14132.50	7069.38	---	21251.35	46506.85	
99.71	3706.92	---	---	10.37	3817.00	
---	8177.56	67.50	---	86905.34	95150.40	
---	39633.48	---	---	2297.51	41930.99	
---	---	---	---	---	---	
42363.28	214849.06	29492.44	430.50	350341.67	637476.95	

ANNEXURE B
INDUSTRY-WISE

Sr. No.	State/AG	No.of cases	Investment Allowance Allowed carried forward	Revenue Forgone	Reserve created
1.	Automobile	14	6006.41	2882.48	4466.66
2.	Pharmaceutical	22	499.77	265.81	227.04
3.	Enginnering	50	10127.27	5466.63	8057.16
4.	Chemical Plastic	35	1604.25	810.39	1471.79
5.	Textile	36	7273.35	4015.98	6597.46
6.	Sugar	21	1772.54	945.22	1638.63
7.	Construction	21	2562.00	1513.68	2016.95
8.	Shipping	6	3576.09	1841.78	1178.28
9.	Tea	13	744.03	253.24	758.93
10.	Electronics & Electricals	3	1387.83	788.48	1006.66
11.	Paper & Plywood	5	794.40	454.21	523.00
12.	Hotel	10	23.75	15.32	121.31
13.	Others	27	6036.54	3054.07	5774.82
	Total	263	42408.23	22307.29	33838.69

Maharashtra	11	
Gujarat	11	Industries wise details not
Kerala	49	furnished.

Fixed capital added for

Replacement	Increased capacity	New Activity	Others including additions to land and building	New assets acquired	Total	Remarks
757.03	18276.80	6939.29	1461.19	29662.02	57096.33	
10.77	2058.24	480.32	25.57	1994.07	4568.97	
3791.50	8515.16	19177.41	774.54	39261.57	71520.18	
823.47	4267.62	1466.30	156.14	12945.73	19659.26	
4669.66	19796.00	10109.39	1189.96	38085.62	73850.63	
1344.56	4914.95	1494.27	792.60	8341.33	16887.71	
556.18	13552.15	2.29	---	8683.18	22793.80	
3353.67	22170.16	---	---	41523.16	67046.99	
61.46	2440.69	12.37	271.32	1235.16	4021.00	
---	6484.82	---	---	1223.32	7708.14	
---	---	3128.35	---	381.92	3510.27	
460.81	391.90	222.57	367.11	793.78	2236.17	
---	17795.12	22.14	154.19	23853.05	41824.50	
15829.11	120663.61	43054.70	5192.62	207983.91	392723.95	

CHAPTER 3

CORPORATION TAX

3.01 **Accordrng to the Department of Company Affairs, Ministry of Law, Justice and Company Affairs, there were 2,27,390 companies as on 31 March 1991*. These included 489 foreign companies and 2,132 associations functioning `not for profit' but registered as companies limited by guarantee and 317 companies with unlimited liability. The remaining 2,24,452 companies with limited liability comprised 1,167 Government companies and 2,23,285 non-Government companies with paid up capital of Rs.49,424.40 crores* and Rs.18,686.20 crores respectively. Among non-Government companies, over 87.99 percent (1,96,472) were private limited companies with a paid up capital of Rs.4,116.80 crores.

3.02 The number of companies on the books of the Income-tax Department during the last five years was as follows:

As on 31 March	Number
1987	77,203
1988	87,985
1989	96,176
1990	1,10,514
1991*	1,25,301

* Provisional figures as furnished by the Ministry of Finance.

** Figures furnished by the Ministry of Industry, Department of Company Affairs.

3.03 The trend of receipts from corporation-tax i.e., income-tax and surtax payable by companies during the last five years was as follows:

*** Provisional**

Year	No. of assessments completed	Receipts (In crores of rupees)	Per capita contribution (in lakhs of rupees)	Gross collection (In crores of rupees)	Percentage of collection to gross collection
1986-87	73,633	3159.96	4.29	6236.46	50.67
1987-88	89,778	3432.92	3.82	6757.18	50.80
1988-89	1,21,595	4407.21	3.62	8828.76	49.91
1989-90	1,04,572	4728.92	4.52	10,007.78	47.25
1990-91*	1,18,625	5335.27	4.49	11,028.94	48.37

* Figures furnished by the Ministry of Finance/Controller General of Accounts are provisional.

3.04 The Action Plan of the Income-tax Department for 1990-91, envisaged the pendency of scrutiny assessments as on 31 March 1991 to be less than as on 31 March 1990.

3.05 The following table indicates the progress in the completion of assessment and collection of demand under corporation tax during the last five years:

Year	No. of assessments completed during the year	No. of assessments Pending at the close of the year	Percentage	Amount of demands collected during the year	Amount of demands In arrears at the close of the year	Amount of demands Per cent age
				(In crores of rupees)		
1986-87	73,633	88,130	119.69	3159.96	1341.21	42.44
1987-88	89,778	54,196	60.36	3432.92	1425.93	41.54
1988-89	1,21,595	41,421	34.06	4407.21	2169.41	49.22
1989-90	1,04,572	50,286	48.08	4728.92	2951.69	62.41
1990-91*	1,18,625	56,804	47.88	5335.27	2590.22	48.54

* **Provisional**

3.06 841 draft paragraphs involving tax effect of Rs.321.91 crores in company assessments were issued to the Ministry of Finance for comments during January 1991 to July 1991. The Ministry of Finance have accepted the observations in 56 cases. 224 important and interesting cases involving tax effect of Rs.201.11 crores of mistakes noticed in the assessments of companies are narrated in the following paragraphs. 36 of these cases were checked by the Internal Audit but the mistakes were not detected by it. In a number of these cases assessment work had been done by Deputy Commissioner of Income-tax (Assessment). The audit observations included in the following chapters of the Report relate to cases subjected to detailed scrutiny by the assessing officers, the observations on cases of summary assessments having been consolidated in paragraph 2.04 of the preceding chapter. The repetitive nature of the mistakes committed by the assessing officers indicates that adequate attention is not being given to scrutiny assessments.

Avoidable mistakes in computation of income and tax

3.07 Mistakes in the computation of total income and in the determination of tax payable, involving substantial revenue are being reported year after year in the audit reports. The extent of such mistakes noticed during test audit of the assessments completed by the tax officers during the last five years was as under:

Year	No. of items	Amounts of tax underassessed (in lakhs of rupees)
1986-87	1,269	2,748.53
1987-88	796	291.84
1988-89	679	1,121.38
1989-90	880	960.63
1990-91	1,153	1135.00

The types of mistakes noticed are :

(i) Incorrect adoption of figures

(ii) Double allowance

(iii) Arithmetical errors

(iv) Calculation errors and other omissions/mistakes

Some important cases noticed in test check are given in the table below :

(i) Incorrect adoption of figures

Sr. No.	State/ Commissioner's charge/	Assessment year/ Date of assessment	Nature of mistake	Tax effect/ Financial implication (in lakhs of rupees)
01.	Maharashtra/ City III Bombay/ Company	1987-88 March 1990	While initially adding to the book results adoption of interest on pension fund debited to accounts as Rs.2 lakhs instead of Rs.2 crores.	147.26
02.	Maharashtra/ City I Bombay/ Company	1986-87 March 1989	The dividend income of Rs.5.49 crores was deducted from the net profit for separate consideration but while computing taxable income only Rs.4.94 crores was added back.	84.24
03.	Karnataka/ Karnataka-I/ Company	1986-87 September 1988	Profit of Rs.19.25 lakhs, before allowing depreciation was adopted as loss while computing total income.	22.24 (P)
04.	Maharashtra/ City-V Bombay Company	1987-88 January 1989	Amount representing undischarged liabilities for disallowance taken at Rs.8.46 lakhs instead of the correct amount of Rs.24.07 lakhs.	8.58
05.	Madhya Pradesh/ Bhopal/ Company	1982-83 January 1987	Mistake in adopting the book results at a loss of Rs.1.60 lakhs instead of a profit of Rs.6.27 lakhs.	8.58

06.	Haryana/ Patiala/ Company	1985-86 August 1985	Figures of expenditure on publicity, etc. erroneously taken at Rs.4.99 lakhs against the correct amount of Rs.49.89 lakhs for the purpose of disallowance on advertisement, publicity, etc.	5.19

Ministry of Finance have accepted the audit observation in three cases.

(ii) Double allowance

1.	Maharashtra/ City VI Bombay	1987-88 November 1989	Mistake in deducting the donation of Rs.3.50 lakhs debited to accounts instead of adding it before allowing the deduction of Rs.1.75 lakhs towards the donation.	5.39

(iii) Arithmetical error

1.	West Bengal/ W.B.I/ Company	1986-87 1987-88 March 1989 March 1990	Omission to add back an amount of Rs.2.52 crores determined by the assessing officer as disallowable for the assessment year 1986-87 resulted in underassessment of income aggregating to Rs.2.22 crores and irregular carry forward of unabsorbed depreciation of Rs.29.41 lakhs involving undercharge of tax of Rs.198 lakhs (including potential tax effect of Rs.14.70 lakhs and interest)	198.00
2.	West Bengal/ W.B. I Company	1987-88 March 1990	Aggregate of the disallowable items was arrived at Rs.25.02 crores instead of the correct figure of Rs.26.02 crores.	71.87
3.	Maharashtra/ City XII, Bombay Company	1988-89 January 1990	Loss incorrectly computed at Rs.29.75 crores as against the correct amount of Rs.28.75 crores.	65.00
4.	Bihar/ Patna/ Company	1980-81 March 1983 March 1990	While deducting the amount of Rs.49.17 lakhs being depreciation and investment allowance debited to the profit and loss account from the loss of Rs.1.32 crores, loss was erroneously computed at Rs.92.42 lakhs instead of the correct amount of Rs.82.42 lakhs.	5.9

Ministry of Finance have accepted the audit observation in one case.

(iv) Calculation errors and other omissions

1.	West Bengal/ W.B. I/ Company	1986-87 March 1989	Two items of statutory liabilities representing provident fund, employees state insurance and other taxes amounting to Rs.1.49 crores and Rs.1.28 crores were held to be disallowable but while computing the total income, loss of only Rs.1.28 crores was deducted from gross loss and Rs.1.49 crores was omitted to be deducted.	101.9
2.	Tamil Nadu/ Central-I, Madras/ Company	1985-86 March 1990	Out of the expenses of Rs.32.02 lakhs debited to accounts and claimed by the assessee, the department decided to allow only 50 percent of Rs.19.72 lakhs on account of expenditure on advertisement and 90 percent of the balance of Rs.12.30 lakhs but while actually allowing the deduction the department incorrectly allowed a deduction of 90 percent of Rs.32.02 lakhs instead of 90 percent of Rs.12.30 lakhs apart from the 50 percent of Rs.19.72 lakhs.	30.3
3.	Maharashtra/ City III Bombay/ Company	1986-87 December 1988	Instead of reducing the excess claim of depreciation of Rs.19.72 lakhs from the total claim of Rs.1.86 crores the same was added to it.	20. 7
4.	West Bengal/ W.B.I Calcutta/ Company	1986-87 January 1989 October 1990	Omission to add the sum of Rs.29.52 lakhs treated as capital expenditure to the total taxable income.	17 .00
5.	Maharashtra/ City XI Bombay/ Company	1986-87 March 1989	Omission to disallow a claim of an amount of Rs.26.48 lakhs being only a provision made in the accounts for payment of gratuity.	10. 5
6.	West Bengal/ W.B.IV/ Company	1988-89 March 1990	In the assessment order the assessing officer decided to add back Rs.10 lakhs in respect of shortage of production but while computing the income no such addition was made.	7. 4,

Ministry of Finance have accepted the audit observation in three cases.

Application of incorrect rate of tax

3.08.1 Under the provisions of the Income-tax Act, 1961, as applicable to companies upto the assessment year 1987-88, long term capital gains arising from the transfer of buildings or lands or any rights in building or lands were chargeable to tax at the rate of 50 percent while other long term gains were chargeable at the rate of 40 percent.

In its return for assessment year 1987-88, a company returned long term capital gain of Rs.66.18 lakhs arising from transfer of building and land. In the assessment completed in January 1990, the assessing officer charged tax at the rate of forty percent only on the above long term capital gain as against the correct rate of fifty percent. The mistake resulted in short levy of tax of Rs.6.62 lakhs.

2. Under the provisions of Income-tax Act, 1961, a company whose business consists mainly of dealing in goods or merchandise manufactured, produced or processed by a person other than company and whose income attributable to such business included in its gross total income is not less than fifty-one percent of such gross total income, shall be treated as a `trading company' and as per provisions of Finance Acts as applicable to the assessment years 1986-87, 1987-88 and 1988-89, a company in which public are not substantially interested, engaged in trading activities or an investment company, would be chargeable to income-tax at the rate of sixty percent of the total income.

(i) In the assessment of a domestic company in which public are not substantially interested for the assessment years 1986-87, 1987-88 and 1988-89, completed in April 1989 (revised) December 1989 and January 1990 by the Dy.Commissioner of Income-tax(Spl.Range), the assessed incomes of Rs.2.45 crores, Rs.1.57 crores and Rs.1.69 crores were taxed at the rate of fifty five percent amounting to Rs.1.35 crores, Rs.86.42 lakhs and Rs.97.64 lakhs respectively. The assessee derived income from brokerage, commission, interest, dividend and house-property. The income from brokerage as a tea broker was

approximately seventy percent of total income. In this particular activity, the assessee collected `tea' from various gardens and conducted sales through its auction centres. Sales-tax was also being collected on these sales. As the income of the assessee to the extent of seventy percent of total income was from trading activities i.e. auction sale of tea, the assessee should have been treated as a trading company and its income charged to tax at the rate of sixty percent of the total income. The mistake in application of rate of tax resulted in short levy of tax aggregating to Rs.29.31 lakhs (Rs.12.57 lakhs, Rs.7.86 lakhs and Rs.8.88 lakhs for the assessment years 1986-87, 1987-88 and 1988-89 respectively).

The department has accepted the audit observation.

(ii) The assessment of a company for the assessment year 1986-87 was completed in March 1989.It was seen in audit that the assessee company was mainly engaged in the business of trading and was treated as a trading company for the earlier assessment year also. Hence the company was liable to be taxed at the rate of 60 percent. However tax was charged at 55 percent and consequently tax amounting to Rs.43.75 lakhs only was levied as against Rs.47.73 lakhs leviable. The mistake resulted in short levy of tax of Rs.6.51 lakhs (including interest leviable for late filing of return and short payment of advance tax).

The department has accepted the audit observation.

3. Under the provisions of the Finance Act, as applicable to the assessment year 1986-87 and onwards, closely held investment and trading companies are chargeable to tax at the rate of 60 per cent and other closely held companies at 55 per cent. The companies in which public are substantially interested are charged to tax at the rate of 50 percent.

(i) The provisional assessment of a company for the assessment year 1987-88 was completed

by the Deputy Commissioner of Income-tax (Spl.Range) in March 1989 on the returned income of Rs.1.11 crores. Tax was levied at the rate of 50 percent as applicable to companies in which public are substantially interested. However, it was seen in audit that the company was treated as an investment company in which public are not substantially interested from the assessment year 1984-85 onwards and tax was leviable at the higher rate of 60 per cent. The application of incorrect rate of tax resulted in short levy of tax of Rs.11.09 lakhs.

The department has accepted the audit observation.

(ii) In the assessment of a company for the assessment year 1989-90, completed in March 1990, the Deputy Commissioner (Spl.Range) recorded that the company was a trading company and also a company in which the public were not substantially interested. Accordingly the company was required to pay tax at the rate of 60 per cent on its income. The tax was however, levied at the rate of 50 percent as against 60 per cent leviable. The application of incorrect rate of tax resulted in short levy of tax of Rs.45.28 lakhs.

Ministry of Finance have accepted the audit observation.

(iii) In the case of an investment company in which the public are not substantially interested, the income for assessment year 1986-87 was determined as Rs.2.95 crores by assessing officer in the assessment completed in March 1989. However, while calculating the tax due, the Deputy Commissioner of Income-tax (Special Range) applied the rate of 50 percent instead of the correct rate of 60 percent applicable. The mistake resulted in short levy of tax of Rs.44.96 lakhs (including interest for short payment of advance tax and for late filing of the return).

The department has accepted the audit observation.

Incorrect status adopted in assessments

3.09.1. Under the provisions of the Income-tax Act, 1961, a company is deemed to be a company in which public are substantially interested if, inter-alia, it fulfils the condition that shares in the company were, as on the last day of the previous year, listed in a recognised stock exchange in India or the shares carrying not less than 50 percent of the voting power throughout the previous year were beneficially held by the Government or a corporation established by the Central, State or Provincial Act or any other company including a cent per cent subsidiary of such company. The incidence of tax is lower in respect of a company in which the public are substantially interested than in case of one in which the public are not substantially interested.

In the assessment of a finance and consultancy company for the assessment years 1984-85 to 1988-89 the company had been treated as a company in which public are substantially interested and taxed at the concessional rate, though there was no evidence on record that the shares were listed in any recognised stock exchange on the last day of the previous year or that the shares carrying not less than 50 per cent of the voting power had been unconditionally held by the Government or statutory corporation. The incorrect treatment of the assessee as a company in which public are substantially interested resulted in short levy of tax of Rs.4.83 lakhs in aggregate during the aforesaid assessment years.

2. If the shares carrying more than fifty per cent of the voting power are held by any foreign association/company, the Central Board of Direct Taxes in their instruction of February 1972 clarified that before treating such a foreign association/company as a company in which public are substantially interested, the Income -tax Officer must satisfy himself that such foreign association/company fulfils all the conditions necessary for being treated as a company in which public are substantially interested. For this purpose, the foreign association/company may be asked to file a

certificate from an established Chartered Accountant testifying to the fact that the foreign association/company fulfils all the conditions for being treated a company in which public are substantially interested. Under the provisions of annual Finance Acts, incidence of tax is lower in respect of company in which public are substantially interested than one in which the public are not substantially interested.

The assessments of a domestic company for the assessment years 1983-84 and 1984-85 were completed in April 1986 and February 1987 (revised in June 1987) respectively, treating the company as one in which public are substantially interested. Shareholding of the company for the relevant previous years revealed that out of the total equity paid up capital of 6,00,000 shares, equity shares to the extent of 4,44,000 were held by four foreign associations/companies. In the absence of any certificate from any established Chartered Accountant testifying to the fact that these foreign associations/companies fulfilled all the conditions for being treated as a company in which public are substantially interested, the assessee company could not be treated as a widely held company and was not, therefore, entitled to the concessional rate of tax applicable to such a company. Though there was no change in the shareholding of the assessee company during the previous year relevant to assessment year 1985-86, the department levied tax at the rate applicable to a company in which public are not substantially interested in the assessment for the assessment year 1985-86. Incorrect application of the rate of tax at the rate of 55 per cent treating the assessee company as one in which public are substantially interested instead of the correct rate of 60 percent thus, resulted in aggregate undercharge of tax of Rs.3.71 lakhs for the assessment years 1983-84 and 1984-85.

Ministry of Finance have accepted the audit observation.

Incorrect computation of Income from House Property

3.10 Under the Income-tax Act, 1961, the annual value of property consisting of any building or lands appurtenant thereto of which the assessee is the owner, other than such portions of such property as he may occupy for the purposes of any business or profession carried on by him the profits of which are chargeable to tax, shall be charged to Income-tax under the head `Income from house property'. It has been judicially held* that if an assessee carries on the business of purchasing and selling buildings, income received from the buildings so long as these are owned by the assessee will be assessed under the head `Income from House Property'.

The assessment of a private limited company for the assessment year 1987-88 was completed in October 1988. As per the Memorandum and the Articles of Association, the company was to deal in real estates. In other words the company was engaged in the business of purchase and sale of building. During the year 1972, the company purchased a building for Rs.55 lakhs and the building was shown in the accounts as stock in trade of the company. Since 1972, there was no other transaction in real estate and the building was occupied by the share holders of the company.The expenses such as municipal taxes, maintenance etc, in respect of the building incurred by the company was reimbursed by the shareholders. It was seen in audit that no income from the house property in respect of the building was brought to tax. As the building was owned by the company, the department should have brought the income from house property to tax in the light of the decision of the Supreme Court. In the absence of the relevant details for determining the house property income, assessing a ten percent return on the investment for each of the years from 1973-74 to 1987-88, there would be an aggregate short levy of tax of Rs.49.50 lakhs, due to escapement of income.

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* C.I.T. Vs. Chug - andas & Company (55-ITR-17 S.C.)

Incorrect allowance of weighted deduction for expenditure on scientific research

Incorrect computation of business income

3.11.1. Under the Income-tax Act, 1961, in computing the business income of an assessee for an assessment year, any sum paid to an approved scientific research association during the relevant previous year is allowable as deduction. Where such a sum is paid for use in scientific research undertaken under a programme approved by the prescribed authority, the assessee is entitled to an additional weighted deduction equal to one-third of the sum paid to the institution. However, the weighted deduction would be available only if the said sum was paid before 1 March 1984.

in its return for the assessment year 1987-88 the previous year of which ended on 30 June 1986, a company claimed deduction for a sum of Rs.50 lakhs paid to Indian Cancer Research Society, an approved institution, for the purpose of scientific research during the relevant previous year. While completing the assessment for the year in March 1990, the assessing officer allowed deduction of Rs.66.66 lakhs which included weighted deduction of Rs.16.66 lakhs for the payment made to the aforesaid institution. As the amount in question was paid to the institution after 1 March 1984 the assessee company was not entitled to the weighted deduction of Rs.16.66 lakhs allowed by the assessing officer. The irregular allowance resulted in under assessment of income by Rs.16.66 lakhs leading to short levy of tax of Rs.11.97 lakhs (including interest leviable on short payment of advance tax.)

2. Expenditure of a capital nature incurred on scientific research related to the business carried on by the assessee is also an admissible deduction.

A widely held company embarked on a project for manufacture of pure electronic grade silicon to modernise and replace the old diaphram cells by the membrane cells process. A sum of Rs.16.42 lakhs incurred during the previous year relevant to the assessment year 1984-85, was allowed in the assessment made

in July 1986 as capital expenditure on research and development for extension of business. Audit scrutiny in September 1990 revealed that the above project was transferred in December 1985 to a wholly owned subsidiary and was actually commissioned by that company in July 1986. It was, therefore, pointed out that the deduction of Rs.16.42 lakhs already allowed for the assessment year 1984-85 as incurred for extension of business would have to be withdrawn in which case the additional demand for this year would be Rs.9.48 lakhs.

Incorrect allowance of expenditure on know-how

3.12.1. Under the provisions of the Income-tax Act, 1961, as applicable from the assessment year 1986-87 any lumpsum consideration paid by the assessee in any previous year for acquiring know-how for use for the purposes of his business will be allowed as deduction in equal instalments spread over six years.

The assessee company entered into a technical collaboration agreement with a foreign company for acquiring know-how for manufacture of motor cycles on a lumpsum condideration of Rs.105.59 lakhs to be paid in three instalments. The last instalment of Rs.35.50 lakhs was paid during the previous year relevant to the assessment year 1986-87. Audit scrutiny (September 1990) revealed that in the assessment of the company for 1986-87 completed in March 1989, a sum of Rs.17.60 lakhs being one-sixth of the total know-how fees paid by the company was allowed. However, the deduction for know-how expenditure should have been allowed at one-sixth of such expenditure incurred during the previous year relevant to assessment year 1986-87 which amounted to Rs.5.92 lakhs and the balance amount of Rs.11.68 lakhs was required to be spread over the succeeding five years. The mistake resulted in excess allowance of deduction amounting to Rs.11.68 lakhs in the assessment year 1986-87 leading to excess carry forward of unabsorbed depreciation allowance involving a potential tax effect of Rs.6.13 lakhs.

2. As the payments are allowed to be

deducted as revenue expenditure such payments cannot be capitalised and treated as any fixed asset from assessment year 1986-87 onwards so as to qualify for depreciation, investment allowance, etc.

In the assessment of a company for the assessment year 1986-87 completed in March 1989 in addition to the one sixth deduction allowable, the assessing officer allowed depreciation and investment allowance aggregating to Rs.15.45 lakhs on the lumpsum consideration paid for acquiring technical know-how. In view of the amendment to the Act, technical know-how cannot be treated as forming part of a capital asset from assessment year 1986-87 and hence no depreciation or investment allowance was allowable on technical know-how. The incorrect allowance resulted in under assessment of income of Rs.15.45 lakhs leading to short levy of tax of Rs.8.50 lakhs.

Mistake in grant of export markets development allowance

3.13.1. The Income-tax Act, 1961, as it stood prior to its amendment by the Finance Act, 1983, provided for export markets development allowance to domestic companies and resident assessees engaged in the business of export of goods outside India or in providing services or facilities outside India. A domestic company was entitled to a deduction on account of this allowance from the income assessed under the head `Profits and gains of business or profession' at one and one-third times the qualifying expenditure as provided in the Act.

While completing the assessment of a Government company for the assessment year 1983-84, in February 1986 the Deputy Commissioner of Income-tax (Special Range) allowed weighted deduction of Rs.93.52 lakhs as export markets development allowance being one-third of Rs.280.57 lakhs. This included one third of the amount of Rs.267.47 lakhs incurred on salary and allowance of staff working on foreign projects and general and site office maintenance expenses which were not covered under the provisions of the Act. This also included expenditure on admissible

items for the month of March 1983 which should have been excluded as the benefit of Section 35B was omitted from 1 March 1983. Such expenditure on pro rata basis worked out to Rs.1.09 lakhs. After excluding the inadmissible expenditure the assessee company was entitled to weighted deduction of Rs.4 lakhs only. The incorrect allowance/weighted deduction resulted in under-assessment of income by Rs.89.52 lakhs involving short-levy of tax of Rs.53.50 lakhs (including interest of Rs.50,467 and Rs.2.52 lakhs leviable under Section 139(8) and 215 of the Act respectively).

The department stated that in the revised order weighted deduction for Rs.4 lakhs only was allowed in March 1990.

2. Commission paid to foreign agents for procuring orders does not, however, qualify for this deduction.

A domestic company claimed and was allowed weighted deduction of Rs.9.33 lakhs for the assessment year 1980-81 (assessment completed by the Inspecting Assistant Commissioner in March 1986) as export market development allowance, being one-third of Rs.28 lakhs paid by the assessee as commission to foreign agents for procuring orders from buyers. As the weighted deduction on such expenditure was not allowable, the grant of deduction resulted in under-assessment of income by Rs.9.33 lakhs involving short levy of tax of Rs.8.50 lakhs (including short levy of interest of Rs.1.05 lakhs for late filing of return and short levy of interest of Rs.1.93 lakhs for short payment of advance tax) for the assessment year 1980-81.

Ministry of Finance have accepted the audit observation.

Incorrect grant of agricultural development allowance

3.14. A company engaged in the manufacture of any article or thing which is made from any product of agriculture, incurring expenditure either directly or through an approved agency in the provision of services, facilities, etc. to cultivators, growers, producers of such product in India,

is entitled to a deduction of a sum equal to the amount of such expenditure. Any such expenditure incurred after 29 February 1984 will not, however, qualify for the deduction. The Central Board of Direct Taxes clarified in July 1968 that expenditure in the form of cash assistance to cultivators, growers or producers will not qualify for the deduction.

A widely held company engaged in the manufacture and sale of sugar claimed deduction of Rs.9.18 lakhs Rs.16.07 lakhs and Rs.47.55 lakhs in its returns for assessment years 1985-86, 1986-87 and 1987-88 towards cane development expenses which were allowed in the assessments completed in March 1988, March 1989 and March 1990 respectively. Audit scrutiny in August 1990 revealed that the expenditure of Rs.9.18 lakhs, Rs.16.07 lakhs and Rs.21.16 lakhs (out of Rs.47.55 lakhs) represented payments by way of various subsidies such as varietal subsidy, transport subsidy, oil engine subsidy, etc. , to the cane growers and other expenses incurred for agricultral operations. As the subsidies were paid to the growers of cane which was the raw material for assessee company`s manufacturing operations, the expenditure had the character of agricultural expenses and such expenses incurred after 29 January 1984 were not allowable under the Act. Further, the subsidies paid to the cane growers being cash assistance to them, did not qualify for the deduction in terms of the Board`s instructions of July 1968. The incorrect allowance of expenditure resulted in excess carry forward of business loss/unabsorbed depreciation of Rs.9.18 lakhs/Rs.25.26 lakhs for the assessment years 1985-86/1986-87 and in reduction of the pre-incentive income for assessment year 1987-88 by Rs.46.41 lakhs involving a tax effect of Rs.27.07 lakhs (including interest of Rs.3.05 lakhs for short payment of advance tax for assessment year 1987-88 and a potential tax effect of Rs.17.06 lakhs due to excess carry forward of investment allowance of Rs.32.49 lakhs).

Incorrect allowance of contributions for rural development programmes

3.15. Under the Income-tax Act, 1961, in computing the business income of an assessee for an assessment year, payment made to an association or institution, which has as its object the undertaking of any programme of rural development, to be used for carrying out any programme of rural development approved by the prescribed authority is allowable as deduction. However, the deduction will be available only if the assessee furnishes a certificate from such association or institution to the effect that the programme of rural development had been approved by the prescribed authority, before 1 March 1983 and where such payment is made after 28 February 1983, such programme involves work by way of construction of any building or other structure for use as a dispensary, school etc., or the laying of any road or construction or boring of a well or tube-well or the installation of any plant or machinery, and such work had commenced before the 1 March 1983. Besides, the deduction will be available only if the payment is made direct to the institution and not through third parties.

In the profit and loss account for the period ended 31 May 1986 relevant to assessment year 1987-88 of a company, an amount of Rs.29.73 lakhs was debited as contribution to NAFED for Associate Agricultural Development Foundation and it was allowed as a deduction by the assessing officer in the assessment completed in March 1988. The amount in question represented contribution to be passed on by NAFED to Associate Agricultural Development Foundation for research and development work for production, handling etc., of agricultural commodities, particularly of onion. Further, the payment had been made after 28 March 1983 and was not on any programme specified in the above mentioned provisions in the Act and the requisite certificate from the institution in question was also not furnished. The payment was also not made direct to the institution. The deduction allowed was, therefore, not in order, and it had resulted in underassessment of income by Rs.29.73 lakhs leading to short levy of tax of Rs.21.63 lakhs (including

short levy of interest on short payment of advance tax and for late filing of return).

Incorrect allowance of contribution to super-annuation fund

3.16 In respect of initial contribution to the superannuation fund, the Central Board of Direct Taxes have clarified that an amount equal to 80 percent of the contribution actually paid to the fund shall be allowed in five equal instalments commencing from the assessment year relevant to the previous year in which the amount was actually paid and four immediately succeeding assessment years.

In the previous year relevant to the assessment year 1979-80, an assessee company made an initial contribution of Rs.50.80 lakhs in its superannuation fund and claimed deduction for the full amount. While making the assessment for that year in September 1982, the assessing officer, however, allowed a deduction of Rs.8.13 lakhs (being one-fifth of 80 percent of Rs.50.80 lakhs) as per Board's instructions. Later, in pursuance of Income-tax Appellate Tribunal's orders the assessment was revised in May 1990 allowing therein deduction of the entire amount of initial contribution of Rs.50.80 lakhs. Prior to this the assessee company made claims for deduction of Rs.8.13 lakhs towards initial contribution to the fund in each of the four assessment years 1980-81 to 1983-84 which were also allowed in the assessments for those years completed between September 1983 and February 1986 and rectified between October 1985 and April 1990. Thus, an excess deduction of Rs.32.52 lakhs in aggregate was allowed to the assessee in the assessments for the years 1980-81 to 1983-84 involving a total undercharge of tax of Rs.24.27 lakhs (including consequential short levy of surtax of Rs.5.49 lakhs).

Irregular deduction allowed on contribution towards other funds

3.17 Under the provisions of the Income-tax Act, 1961, as introduced by the Finance Act, 1984, with retrospective effect from 1 April 1980, in computing the business income of an assessee, no deduction shall be allowed in respect of any sum paid by the assessee as an employer towards the setting up or formation of, or as contribution to, any fund or other institution for any purpose except where such

sum is paid by way of contribution towards a recognised provident fund, approved gratuity fund, approved superannuation fund created for the benefit for the employees

In the case of two public limited companies for the assessment year 1988-89, the assessees claimed deductions of expenditure of Rs.44.12 lakhs and Rs.38.39 lakhs in respect of contributions to schools and clubs. In the assessments completed in December 1989 and January 1990, disallowance, in one case, of Rs.14.59 lakhs out of Rs.44.12 lakhs was made on account of donations to charitable institutions for separate consideration (but not allowed, there being no positive income) and the remaining expenses of Rs.29.53 lakhs and Rs.38.39 lakhs were allowed. The expenditure being by way of grants to various institutions and not incurred directly by the assessee on welfare of employees was not allowable. The incorrect allowance of deductions resulted in excess losses of Rs.67.92 lakhs being allowed to be carried forward for set off involving potential short levy of tax aggregating to Rs.35.66 lakhs.

Incorrect allowance of capital expenditure

3.18.1 Under the provision of the Income-tax Act, 1961, any expenditure not being expenditure of capital nature or personal expenses of the assessee, laid out or expended wholly and exclusively for the purpose of the business is allowable as deduction in computing income chargeable under the head `Profits and gains of business or profession'.

An assessee company debited Rs.97.69 lakhs, Rs.119.23 lakhs and Rs.83.40 lakhs in its accounts of the previous years relevant to the assessment years 1985-86, 1986-87 and 1987-88 respectively under the heads repairs to buildings and machineries. While completing assessments for the assessment years 1985-86 to 1987-88 in March 1988, January 1989 and March 1989, the Deputy Commissioner (Assessment) allowed the entire expenditure treating it as revenue expenditure as claimed by the assessee. Audit scrutiny (November 1989) of Board of

Director's report revealed that major expenditure under the `Scheme of Development' was incurred during all the three assessment years for modernisation of factories, updating the agricultural techniques and for providing better housing and water supply facilities to achieve maximum efficiency and improve productivity. In the absence of break-up of expenditure incurred under development scheme and for routine repairs, expenditure of capital nature debited to revenue, as estimated in audit comes to Rs.62.27 lakhs, Rs.81.09 lakhs and Rs.49.05 lakhs in the assessment years 1985-86, 1986-87 and 1987-88 respectively after allowing expenditure chargeable to revenue with reference to assessment year 1984-85 and deducting therefrom allowable depreciation. These expenses under development scheme having been of capital nature, charging the same under revenue should have been disallowed in assessment. Omission to disallow the same resulted in underassessment of income of Rs.76.97 lakhs involving undercharge of tax of Rs.62.67 lakhs (including interest of Rs.17.44 lakhs for belated submission of returns and short payment of advance tax).

Ministry of Finance have accepted the audit observation.

2. From the relevant Tax Audit Report on the accounts of an assessee, a widely held company engaged in the construction of ships for the purpose of use in its own business for the year 1987-88 relevant to the assessment year 1988-89, it transpired that valuation of such ships is done at lower of the cost or the price determined by the assessee and capitalisation is done on the value so determined. In the previous year relevant to the assessment year 1988-89, three vessels were, accordingly, capitalized at a price of Rs.267 lakhs and depreciation at ten percent on that was allowed. The said value was, however, lower than the actual cost of construction by Rs.169.09 lakhs. Thus, the said difference of Rs.169.09 lakhs between the actual cost of Rs.436.09 lakhs and the value determined (Rs.267 lakhs) for

capitalisation, stood charged to revenue in the profit and loss accounts to the extent of Rs.112.38 lakhs in 1987-88 relevant to assessment year 1988-89 and Rs.56.71 lakhs in the earlier years 1986-87 and 1987-88. The relevant Tax Audit Report also observed that the method of valuation of the vessels followed by the assessee was not based on any accepted principles. As the adjustment of the difference in capital expenditure was debited to the profit and loss account as revenue charge, the same should have been disallowed in assessment. However, in the regular assessment completed by the Deputy Commissioner of Income-tax (Special Range) in January 1990, the assessing officer did not disallow the same. The mistake resulted in excess determination of loss to the extent of Rs.101.14 lakhs (capital expenses disallowable Rs.112.38 lakhs less proportionate depreciation allowable at 10 percent on the capital value = Rs.11.24 lakhs). The irregular carry forward of loss of Rs.101.14 lakhs involved potential tax effect of Rs.53.10 lakhs. A review of the assessments for earlier years (1986-87 and 1987-88) may also be called for.

3. A private limited company engaged, **inter alia**, in the business of processing of mica and sale and export thereof to foreign countries debited a sum of Rs.37.32 lakhs in the profit and loss account for the previous year relevant to the assessment year 1986-87 against `Silver Plant'. In the assessment completed in December 1989, the assessing officer did not disallow and add back the said expenditure debited in the accounts. As the said silver plant was utilised for the purpose of processing raw mica into silvered mica, the expenditure incurred in acquiring the said plant was in the nature of capital expenditure and was not allowable as revenue expenditure. Incorrect allowance of the expenditure resulted in underassessment of income of Rs.31.72 lakhs (after allowance of normal depreciation) with consequent undercharge of tax of Rs.28.62 lakhs (including short levy of interest of Rs.10.31 lakhs for late filing of return and short

payment of advance tax) for the assessment year 1986-87.

The department has accepted the audit observation.

4. It has been held judicially* that pre-production expenses incurred in connection with bringing the assets into existence and putting them in working condition have also to be included in the actual cost of the assets, i.e. have to be capitalised.

A company engaged in the manufacture of detergent cakes and high density powder as part of Phase I of its project, proposed to start production of spray dried powder in Phase II. In its assessment for the assessment year 1983-84, completed in January 1986, the assessee claimed and was allowed a deduction of Rs.23.12 lakhs towards pre-operation expenses relating to Phase II, which had not yet been commissioned. It was noticed in audit that this represented expenses incurred in connection with the erection/installation of the plant and machinery, and putting them in working condition, and that these had not been charged to the revenue account even by the assessee. As the expenditure was capital in nature, its allowance as revenue expenditure was not in order, and resulted in excess carry forward of loss of Rs.23.12 lakhs, involving potential short levy of tax of Rs.13.03 lakhs.

The department has accepted the audit observation.

Incorrect allowance of bad debts

3.19 Under the provisions of the Income-tax Act, 1961, as in force prior to 1 April 1989, the amount of any debt which is established to have become bad in the previous year is allowable as deduction subject to certain conditions. In the case of the rural branches of commercial banks which are allowed to make adequate provision from their current profits to provide for risks in relation to their

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* 109-ITR-451 C.I.T. Vs. Sabari Mills Pvt. Ltd., 127-ITR-37 Shri Vallabh Glass Works Ltd. Vs. C.I.T. Gujarat III

rural advances with effect from assessment year 1985-86, the amount of deduction in relation to any such bad debt shall be limited to the amount by which it exceeds the credit balance in the provision made for such bad and doubtful debts.

In the assessment of a public sector bank for the assessment year 1986-87 completed by the Deputy Commissioner of Income-tax (Special Range) in March 1989, the assessing officer allwed deduction of Rs.26.10 lakhs on account of bad debts though the balance under the head provision for bad and doubtful debts was Rs.124.97 lakhs. As the amount of bad debts written off was less than the provision under the relevant head no further deduction on account of bad debts was admissible. The mistake resulted in underassessment of income by Rs.26.10 lakhs involving short levy of tax of Rs.13.70 lakhs.

Ministry of Finance have accepted the audit observation.

Incorrect allowance of provisions for doubtful debts

3.20 Under the Income-tax Act, 1961, a provision made in the accounts for an accrued or known liability under the Act is an admissible deduction while other provisions made do not qualify for the deduction while computing the business income of an assessee. A provision made in the accounts for doubtful debts is not an allowable deduction.

A public limited company debited in its profit and loss account relevant to assessment year 1986-87 an amount of Rs.19.64 lakhs being provisions for doubtful debts. While completing the assessment in March 1989, the Deputy Commissioner of Income-tax (Special Range) allowed the aforesaid provision as a deduction as claimed by the company. As the amount was merely a provision and not an ascertained liability, it was not an allowable deduction. The mistake resulted in underassessment of income of Rs.19.64 lakhs involving short levy of tax of Rs.14.82 lakhs (including interest of Rs.4.51 lakhs for short payment of advance tax).

Incorrect computation of income of a scheduled bank

3.21 In the case of scheduled banks engaged in banking operations outside India, the Income-tax Act, 1961, provides for a special deduction in the computation of their taxable profits,of the amounts transferred by them out of such profits to a special reserve account upto an amount not exceeding 40 percent of their total income as computed before making any deduction under these provisions and under Chapter VIA of the Act. The deduction is, thus, to be limited to the amount actually carried specifically to the special reserve account in the accounts of the relevant previous year. It has been judicially held* that the creation of a reserve fund under the Banking Companies Act was not sufficient compliance to the provisions of the Income-tax Act regarding creation of reserve for the purposes of grant of development rebate, though the amount carried to the reserve under the Banking Companies Act is large enough to cover the requirements of the Income-tax Act. Any amount which is merely debited as a provision in the profit and loss account and is not credited to the specific special reserve account shown as such in the balance sheet would not be eligible for deduction under the above provision.

In the assessment of a public sector scheduled bank for the assessment year 1987-88, completed as a scrutiny case in March 1990, the Deputy Commissioner (Special Range) allowed deduction of Rs.137.05 crores under the above mentioned provisions in the Act. It was, however, seen in audit that the bank had during the relevant previous year actually transferred to the special reserve account an amount of Rs.23.26 crores only. While allowing the deduction of Rs.137.05 crores, the assessing officer took into account a provision made for this purpose amounting to Rs.113.79 crores debited in the accounts. As the deduction under the Act is to be allowed only in respect of amount actually carried to special reserve account as specifically laid down in the Act, the aforesaid provision of Rs.113.79 crores, which was not carried to

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* 77-ITR-512

the special reserve account during the previous year relevant to assessment year 1987-88, did not qualify for the deduction allowed by the assessing officer. There was, therefore, an excess allowance of deduction by Rs.113.79 crores leading to short levy of tax of Rs.84.63 crores (inclusive of interest leviable on short payment of advance tax and for late filing of the return).

Incorrect deduction of loss on account of fluctuation in the rate of exchange

3.22.1 The Ministry of Law clarified in October 1984 that exchange loss arrived at on the basis of fluctuation in the rate of exchange and not backed by actual remittance, cannot be allowed as a deducion in computing the total income under the Income-tax Act.

During the previous year relevant to the assessment years 1986-87 and 1987-88, an assessee company in which public were substantially interested, debited in its accounts sums of Rs.84.64 lakhs and Rs.66 lakhs towards exchange loss due to fluctuation in the rate of exchange and claimed deductions therefor. In the assessments for these years, completed in March 1989 and March 1990, the Deputy Commissioner of Income-tax (Special Range), however, allowed deductions of Rs.14.64 lakhs (disallowing Rs.70 lakhs as capital expenditure) and Rs.66 lakhs respectively against the claims of the assessee. It was noticed that out of the exchange loss of Rs.14.64 lakhs and Rs.66 lakhs allowed in the assessments, only an amount of Rs.1.68 lakhs and Rs.3.48 lakhs relating the assessment years 1986-87 and 1987-88 were actually remitted by the assessee company. Since the balance amount of Rs.12.96 lakhs and Rs.62.52 lakhs were not backed by actual remittance and the loss arisen due to fluctuation in the rate of exchange on the first and last days of accounting years, the allowance of exchange loss as a deduction in the computation of business income was not in order. The mistake resulted in underassessment of income by Rs.12.96 lakhs and Rs.62.52 lakhs in the assessment years 1986-87 and 1987-88 respectively with consequential undercharge of tax of Rs.41.13

lakhs in two years in the aggregate (including short levy of interest of Rs.3.06 lakhs for short payment of advance tax in assessment year 1986-87).

2. During the previous year relevant to the assessment year 1987-88, an assessee tea company debited in its accounts Rs.127.04 lakhs towards exchange loss due to fluctuations in the rate of exchange and the same was allowed as deduction in the assessment completed by the Deputy Commissioner of Income-tax (Assessment) in March 1990. Since the loss had arisen due to fluctuations in exchange rate on the first and last day of accounting year and there was no remittance in foreign currency from India, the loss on fluctuations was a notional loss. Such notional loss of Rs.98 lakhs was, also disallowed in the earlier assessment year. The allowance of notional loss in computing the business income for the assessment year 1987-88 was accordingly not in order. The mistake resulted in underassessment of income of Rs.50.82 lakhs involving undercharge of tax of Rs.44.94 lakhs (including interest of Rs.19.53 lakhs for short payment of advance tax).

3. During the previous year relevant to the assessment year 1987-88, an assessee company in which public are substantially interested debited its profit and loss account with a sum of Rs.99.92 lakhs towards exchange loss due to fluctuations in rate of exchange and the same was allowed as deduction in the assessment for the assessment year 1987-88 completed by the Deputy Commissioner of Income-tax (Special Range) in March 1990. Since there was no actual remittance of the foreign currency during the previous year, the allowance of exchange loss to the tune of Rs.99.92 lakhs was not in order. The mistake resulted in underassessment of income of Rs.39.97 lakhs (40 percent of Rs.99.92 lakhs being a tea company) with consequent short levy of tax of Rs.34.39 lakhs (including interest of Rs.14.40 lakhs for short payment of advance tax).

Omission to disallow excess in expenditure on advertisement, publicity and sales promotion

3.23 Under the Income-tax Act, 1961, as applicable during the period 1 April 1984 to 31 March 1986, where the expenditure or the aggregate expenditure incurred by an assessee on advertisement, publicity, sales promotion, running and maintenance of air craft and motor cars and payment made to hotels exceeds one hundred thousand rupees, 20 percent of such excess is not to be allowed as deduction in computing the income chargeable under the head `Profits and gains of business or profession'.

In the assessment of a closely held pharmaceutical company for the assessment year 1984-85 completed in March 1987 by the Deputy Commissioner of Income-tax (Assessment) an amount of Rs.40.07 lakhs being sales scheme and price difference, adjusted and shown as reduction in sales turnover, was not considered for partial disallowance to the extent of Rs.8.01 lakhs. Omission to disallow the expenditure resulted in short levy of tax of Rs.4.93 lakhs.

Incorrect allowance of expenditure on guest house

3.24 Under the provisions of the Income-tax Act, 1961, no deduction is allowed in respect of any expenditure incurred by an assessee after 28 February 1970 on the maintenance of any residential accomodation in the nature of guest houses. The Act was amended retrospectively with effect from April 1979 by the Finance Act, 1983, to include any accommodation, by whatever name called, arranged by the assessee for the purpose of providing lodging or boarding and lodging to any person (including an employee or company director) on tour or visit to the place at which such accommodation is situated. The provisions are also applicable in case of such expenses incurred in connection with maintainance of guest houses outside India.

In the assessments of a closely held company for the assessment years 1987-88 and 1988-89, completed in December 1989 (rectified in June 1990) and March 1990, the assessing officer allowed expenses of Rs.9.21 lakhs and Rs.5.69 lakhs respectively on maintenance of guest houses at different work sites abroad. It was contended that as per terms of employment,

the employees and directors of the company were entitled to free board and lodging in those guest houses as they were not entitled to any daily allowance where the company provided such guest houses. Hence such guest houses were not of the nature of guest house as contemplated in the aofresaid provisions of the Act. The assessing officer was inclined to treat the facilities so provided as perquisites. The treatment of the expenditure on guest houses as allowable, on the ground aforesaid as recorded in the assessment, was not in terms of the provisions of the Act regulating such expenses. The Act does not make any distinction between the guest houses providing services free of cost as part of contractual obligation and those providing the same otherwise. The Act prohibits, in clear terms, allowance of any expenditure on the maintenance of guest houses. Incorrect treatment of the aforesaid expenditure in the respective assessments led to irregular allowance of Rs.9.21 lakhs and Rs.5.69 lakhs in the assessment years 1987-88 and 1988-89 with underassessments of Rs.9.21 lakhs in assessment year 1987-88 and excess carry forward of depreciation of Rs.5.69 lakhs in assessment year 1988-89. As the assessment for the assessment year 1987-88 resulted in refund there was excess refund of Rs.5.07 lakhs in that assessment year and potential tax effect of the excess carry forward of depreciation in the assessment year 1988-89 was Rs.3.29 lakhs, the total tax effect aggregating to Rs.8.36 lakhs.

Incorrect allowance of provisions

3.25. Under the Income-tax Act, 1961, any expenditure laid out or expended wholly and exclusively for the purpose of business or profession shall be allowed in computing the business income of an assessee provided the expenditure is not in the nature of a capital nature or personal expenses of the assessee.

A provision made in the accounts for an accrued or known liability is an admissible deduction, while other provisions made do not qualify for deduction. Further with effect from assessment year 1984-85 in computing the business income of an assessee a deduction

for any sum payable by the assessee by way of tax of duty under any law for the time being in force or for any sum payable by him as an employer by way of contribution to any provident fund or superannuation or gratuity or any other fund for the welfare of the employees, will be allowed out of the income of the previous year in which such sum is actually paid irrespective of the method of accounting employed by the assessee. In other words, these deductions are admissible only on actual payment and not on accrual basis.

1. An assessee company debited in its profit and loss account for the previous year relevant to the assessment year 1985-86 an amount of Rs.3,505.11 lakhs, being provision for taxes in India and abroad (Rs.2,500 lakhs, Rs.365.68 lakhs), project performance (Rs.587.86 lakhs) and liquidated damages (Rs.51.57 lakhs). While completing the assessment in October 1987, the assessing officer disallowed Rs.2,500 lakhs only being provision for tax in India and allowed the remaining amount of Rs.1,005.11 lakhs as admissible deduction. As the provisions were not ascertained liabilities these were not allowable as deduction in computing of business income. The mistake resulted in underassessment of income of Rs.1,005.11 lakhs involving short levy of tax of Rs.580.45 lakhs.

The department has accepted the audit observation.

2. In the case of a Government company for the assessment year 1986-87, the assessment of which was completed in March 1989, the company made a provision by debiting in its profit and loss account for the period ending 31 March 1986 relevant to the assessment year 1986-87, an amount of Rs.779.66 lakhs being `overburden accounting'. As the amount was merely a provision and not an actual expenditure or ascertained liability it was not an allowable deduction. The omission resulted in excess computation of loss by Rs.779.66 lakhs in the assessment year 1986-87 with consequent potential tax effect of Rs.409.32 lakhs.

The department has accepted the audit observation.

3. In the case of a Government company for the assessment year 1985-86 (assessment completed in October 1987), the Deputy Commissioner of Income-tax (Special Range) allowed a deduction of Rs.498.80 lakhs on account of provision for foreign projects. This being merely a provision did not qualify for deduction and was required to be disallowed and added back to the taxable income of the assessee. The omission to do so resulted in underassessment of income of Rs.498.80 lakhs involving tax effect of Rs.288.06 lakhs.

The department has accepted the audit observation.

4. In the assessment of a limited company, engaged in the mining of coal, for the assessment year 1988-89, completed in January 1990, by the Deputy Commissioner of Income-tax (Assessment), deductions for Rs.483.34 lakhs and Rs.17.06 lakhs were allowed on account of provisions made by the assessee for Stock depreciation of coal' and "slow moving/non-moving and obsolescence" respectively. These provisions being unascertained liabilities on account of future losses, were required to be disallowed which was not done. The omission resulted in excess computation of loss by Rs.500.40 lakhs involving potential short levy of tax of Rs.262.71 lakhs.

5 An assessee, a Government company, made a provision of Rs.2.36 crores in its accounts for the year 1983-84 relevant to assessment year 1984-85 on account of central excise duty on yarn at spindle stage. Since the assessee had not made any payment of the duty, the entire amount of provision was required to be disallowed in the computation of income for assessment year 1984-85. However, only a sum of Rs.13.62 lakhs was disallowed in the assessment order passed in March 1987. The mistake resulted in underassessment of income of Rs.2.23 crores

involving potential short levy of tax of Rs.1.29 crores.

6. In the assessment of a widely held company for the assessment year 1988-89, completed by the Deputy Commissioner of Income-tax (Special Range) in February 1990 at a loss of Rs.778.64 lakhs, an expenditure of Rs.206.70 lakhs (included in Rs.2,845.22 lakhs under the head `Employees remuneration and benefits') representing provision for gratuity payable to the employees was allowed. The provision of Rs.206.70 lakhs debited to accounts included an amount of Rs.35.03 lakhs being gratuity paid/payable during the relevant previous year and the balance amount of Rs.171.67 lakhs was only provision. As the gratuity fund was not approved for purposes of income-tax the assessee was not entitled to allowance of any sum as contribution. It was noticed in audit that in the earlier years the assessee was allowed deduction and allowance towards gratuity actually paid to the employees. The allowance of the aforesaid provision of Rs.171.67 lakhs was, therefore, irregular and had led to excess carry forward of loss of Rs.171.67 lakhs involving potential undercharge of Rs.90.13 lakhs.

7. In the assessment of a company for the assessment year 1984-85 completed by the Deputy Commissioner of Income-tax (Special Range) in December 1986 and modified as per appellate orders in March 1990, provisions for outstanding lease rent of Rs.77.15 lakhs payable to the State Government as royalty was not added back in computing business income. It was observed in audit that out of provision for lease rent of Rs.242.15 lakhs made in the accounts, an amount of Rs.77.15 lakhs related to assessment year 1984-85. Omission to add back this unpaid Government dues resulted in undercharge of tax of Rs.62.60 lakhs (including interest of Rs.89,106 for belated submission of return and Rs.17.15 lakhs for short payment of advance tax without an estimate).

8. The assessee, a widely held company, debited in its profit and loss account

relevant to the asessment year 1988-89 a sum of Rs.100 lakhs on `provision for contingency'. This provision was made for meeting future losses against slow moving stores under work-in-progress, which was not an accrued, known or ascertained liability. The provision was, therefore, disallowable in the computation of income. However, in the assessment for the said assessment year completed in February 1990 at a loss of Rs.778.64 lakhs the Deputy Commissioner of Income-tax (Special Range) erroneously allowed the provision instead of disallowing it. The mistake led to excess carry forward of loss of Rs.100 lakhs involving potential tax effect of Rs.52.50 lakhs.

9. A company in which public are substantially interested debited in its profit and loss accounts for the previous year relevant to the assessment year 1987-88, a sum of of Rs.54.35 lakhs as provisions for expenses. The Deputy Commissioner of Income-tax (Special Range) while completing the assessment in March 1990 allowed the same. It was, however, noticed in audit (November 1990) that the assessee had communicated to the department in March 1989 that the aforesaid sum of Rs.54.35 lakhs was a mere provision. The amount, being merely a provision and not an ascertained liability, was not an allowable deduction. The incorrect allowance of provision resulted in underassessment of income of Rs.54.35 lakhs involving short levy of tax of Rs.27.18 lakhs for the assessment year 1987-88.

10. In the case of a private limited company, during the previous year relevant to the assessment year 1985-86, the assessee had made provision for penal interest, non-agricultural assessment charges and service charges amounting to Rs.9.70 lakhs on the basis of the statement received from the Gujarat Industrial Development Corporation to the extent of the liability acknowledged. The assessee also paid and debited notified area charges pertaining to earlier years amounting to Rs.32,150 on the basis of demand received during the year from Gujarat Industrial Development Corporation. As these charges

relate to land held by the assessee on a long term lease for 99 years, the expenditure was of capital nature and was required to be disallowed. Failure to do so resulted in underassessment of income of Rs.10.02 lakhs involving short levy of tax of Rs.5.78 lakhs.

11. In the assessments of four companies for the assessment years 1984-85 and 1987-88 to 1988-89 assessed in seven different Commissioners' charges the assessing officers erroneously allowed deductions amounting to Rs.68.96 lakhs in respect of unpaid liabilities on account of sales-tax/purchase tax/custom duty/central excise duty/entry tax and export pass fee/contribution to provident funds, superannuation funds, etc., which were outstanding in the balance sheets as unpaid liabilities at the end of the relevant previous years. The omission to add back the unpaid liabilities resulted in undercharge of tax aggregating to Rs.48.86 lakhs (including potential tax effect and short/non levy of interest). The details of the cases are as under:

Sr. No.	Commissioners' charge / Name of assessee	Assessment year	Amount of unpaid liabilities (in lakhs of rupees)	Tax effect
1.	W.B.IV, Calcutta	1987-88	7.50	5.93
2.	City II, Bombay	1984-85	34.98	27.72
3.	W.B.V, Calcutta	1984-85	14.67	8.47
4.	M.P. Jabalpur	1988-89	11.81	6.74

12. The assessment of a public limited company for the assessment year 1985-86 was made by the Deputy Commissioner of Income-tax in March 1988 allowing a deduction of Rs.176 lakhs. The deduction was on account of a disputed arrear claim of electricity duty of earlier years (retrospective) made by a State Electricity Board in respect of which the assessee had neither made a provision in the accounts nor was the liability thereof discharged to the end of the previous year relevant to the assessment year 1985-86. A similar claim of Rs.224 lakhs was made by the assessee in the assessment year 1984-85 was

rejected by the assessing officer as this amount remained unpaid at the end of the accounting year relevant to the assessment year 1984-85. The irregular deduction of the disputed and unpaid liability of Rs.176 lakhs resulted in over computation of loss by an identical amount involving notional tax effect of Rs.102 lakhs.

Ministry of Finance have accepted the audit observation.

Mistakes in the computation of income from tea business

3.26.1. Under the Income-tax Rules 1962, only 40 percent of the income derived from the sale of tea grown and manufactured in India is deemed to be income derived from manufacturing and selling operations of the assessee and liable to income-tax, the remaining 60 percent being deemed to relate to the cultivation of tea, income from which is agricultural in nature and hence not liable to income-tax. It has been judicially held* that this rule regarding apportionment of income applies only to the income from tea business and not to any other income by way of interest on loans advanced by the concerns.

The assessment for the assessment year 1987-88 of a widely held company engaged in the business of growing and manufacturing tea, investment in shares and also having income from house property and other sources was completed in March 1990 at Rs.7.56 crores. The assessee company had interest income of Rs.1.23 crores on loans advanced to several parties (outside tea business) while the interest payment relating to tea business was Rs.4.10 crores including Rs.73.37 lakhs on inter-corporate loan. In the assessment, the assessing officer assessed net interest income of Rs.49.61 lakhs under `other sources' after adjusting interest payment on inter-corporate loan of Rs.73.37 lakhs from the interest receipt of Rs.1.23 crores. As the company was engaged in business of cultivation and manufacture of tea interest on borrowings made for running tea business

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* **84-ITR-643 - Commissioner of Agricultural Income-tax Madras Vs. Periakamalai Tea & Produce Co. Ltd. and others**

were required to be treated as business expenditure and not incurred for earning adjusted interest income. The irregular adjustment of Rs.73.37 lakhs being interest incurred on business, against `other interest receipt' of Rs.1.23 crores assessable under `other sources' led to net underassessment of income by Rs.44.02 lakhs (gross underassessment Rs.73.37 lakhs less 40 percent of Rs.73.37 lakhs i.e. Rs.29.35 lakhs chargeable against tea business). In the earlier year the department took whole of interest income under other sources'. This led to undercharge of tax of Rs.22.01 lakhs and consequential short levy of interest for short payment of advance tax to the extent of Rs.9.63 lakhs, the aggregate revenue effect being Rs.31.64 lakhs.

2. In the assessment of a closely held company engaged in the business of growing and manufacturing tea for the assessment year 1988-89 completed in March 1990, the Deputy Commissioner of Income-tax (Special Range) determined the income from tea business after allowing Investment allowance' of Rs.12.85 lakhs from the apportioned taxable income of the assessee. Under the provisions of the Income-tax Act, deduction on account of investment allowance is admissible from the composite total income of the assessee before apportionment. The deduction of the entire investment allowance from the apportioned income from tea business, therefore, resulted in underassessment of income of Rs.7.71 lakhs (60 percent of Rs.12.85 lakhs with consequent short levy of tax of Rs.6.12 lakhs (including interest of Rs.1.28 lakhs and Rs.38,695 for short payment of advance tax and belated submission of return respectively, for the assessment year 1988-89).

Other mistakes in the computation of business income

3.27.1. Under the Income-tax Act, 1961, income chargeable under the head `Profits and gains' of business or profession is computed in accordance with the method of accounting regularly employed by the assessee. Where an assessee follows mercantile system of accounting, the net profit or loss is calculated after taking into account all the income actually received as well as accrued

or deemed to accrue as well as expenditure and the liability incurred relating to the period, regardless of their actual receipt or payment.

(i) The assessment of a public limited company for the assessment year 1987-88 was completed in March 1990 on a total income of Rs.1.19 crores. It was noticed in audit in October 1990 that according to a note in the Tax Audit Report appended to the accounts ending on 31 December 1986, a sum of Rs.22.70 lakhs representing expenses relating to earlier years was debited to the profit and loss account. As the assessee was following mercantile system of accounting, earlier year's expenses were not admissible deduction. The incorrect allowance thereof resulted in underassessment of income by Rs.22.70 lakhs with consequent short levy of tax of Rs.11.35 lakhs for the assessment year 1987-88.

(ii) An assessee tea company following mercantile system of accounting debited Rs.13.97 lakhs in the accounts for the previous year relevant to assessment year 1984-85 for the commission and brokerage payable on unsold stock, excise duty liability awaiting despatch for Rs.3.24 lakhs and made provision for bad debts of Rs.3.23 lakhs. Below the accounts the assessee also disclosed prior years' adjustment of Rs.3.41 lakhs and provision for bad debt written back at Rs.33,299. While completing the regular assessment in March 1990, as per direction of the appellate authority, the commission and brokerage payable on unsold stock not related to this previous year was not disallowed and tax liability remaining outstanding was not also added back. Further, provision for bad debt which had not been established to have become bad had been allowed. Again, adjustment of previous period had been allowed in computing income though not claimed by the assessee and also excess provision for bad debt written back was not taken into account. The aforesaid omissions and irregular allowance of expenditure resulted in underassessment of income of Rs.9.67 lakhs with consequent undercharge of

tax of Rs.8.19 lakhs (including interest of Rs.2.43 lakhs for short payment of advance tax and Rs.18,148 for late filing of return).

2. In the accounts for the previous year relevant to the assessment year 1985-86, an assessee company debited a sum of Rs.17.43 lakhs representing prior period expenses to its profit and loss account. While completing the assessment for the assessment year 1985-86 in October 1987, the Deputy Commissioner of Income-tax (Special Range) disallowed a sum of Rs.4.04 lakhs only. As the assessee was following the mercantile system of accounting and the assessments for the earlier assessment years were completed after considering all the expenditure incurred by the assessee the entire amount of Rs.17.43 lakhs should have been disallowed. The omission to do so resulted in underassessment of income by Rs.13.39 lakhs involving short-levy of tax of Rs.7.73 lakhs.

Ministry of Finance have accepted the audit observation.

3. In the assessment of a company for the assessment year 1986-87, completed in February 1989, a deduction of Rs.49.03 lakhs was allowed being statutory liability disallowed in the assessment of the assessment year 1985-86. It was seen in audit that in the original order for the assessment year 1985-86 even though the assessing officer had disallowed the outstanding liability of Rs.49.03 lakhs, an amount of Rs.27.95 lakhs out of Rs.49.03 lakhs was allowed by the Commissioner of Income-tax (Appeals) and effect to the appellate order was given in December 1989. Therefore, the deduction already allowed in the assessment year 1986-87 should have been withdrawn to the extent of Rs.27.95 lakhs, which was not done. It was further seen that the assessment for the assessment year 1986-87 underwent revision in February 1990 and again in July 1990, but the excess deduction was not withdrawn.

Similarly, in the assessment of the assessment year 1987-88, completed in

February 1990, a deduction of Rs.29.77 lakhs was allowed being unpaid sales tax and custom duty liability disallowed during the assessment for the assessment year 1986-87. Here also the assessment for the assessment year 1986-87 underwent revision in July 1990 to give effect to appellate orders in which an amount of Rs.22.31 lakhs out of Rs.29.77 lakhs disallowed was allowed. In view of the relief allowed, the deduction allowed in the assessment year 1987-88 should also have been withdrawn to the extent of Rs.22.31 lakhs, which was not done till the date of audit. The above mistakes resulted in underassessment of income of Rs.27.95 lakhs in the assessment year 1986-87 and Rs.22.31 lakhs in the assessment year 1987-88 leading to short levy of tax aggregating to Rs.31.43 lakhs (including interest of Rs.5.58 lakhs leviable for short payment of advance tax).

4. In the assessment of a company for the assessment year 1985-86 completed in March 1988, the assessing officer allowed deduction of Rs.8.69 lakhs on account of sales tax on the ground that sales tax liability disallowed in the earlier assessment year 1984-85 was paid in the relevant previous year. It was seen in audit that the Commissioner of Income-tax (Appeals) in his order (February 1989) had deleted the disallowance of Rs.8.69 lakhs made in the assessment order for the assessment year 1984-85 and the appeal order was also given effect in August 1989. The assessment for the assessment year 1985-86 also should have been revised to withdraw the deduction of Rs.8.69 lakhs. The omission to do so resulted in underassessment of income of Rs.8.69 lakhs for assessment year 1985-86 involving short levy of tax of Rs.5.02 lakhs.

Ministry of Finance have accepted the audit observation.

5. A closely held company credited sales tax of Rs4.75 lakhs and Rs.5.07 lakhs collected during the previous years relevant to the assessment years 1986-87 and 1987-88 to a separate account' outside the profit and loss accounts. The sales-tax so collected

and kept out of trading receipts remained unpaid till the end of April 1986 **i.e.** upto the end of the previous year relevant to the assessment year 1987-88. As the assessee did not take the collections as trading receipts nor were these wiped off by way of payment to the State/Central Government or by refund to purchasers, the amount of collection should have been included in the total income of the respective assessment years in the assessments completed in December 1989 and March 1990 respectively. Omission to include these in assessments led to underassessment of income by Rs.4.75 lakhs and Rs.5.07 lakhs with aggregate undercharge of tax of Rs.6.78 lakhs (including interest of Rs.1.25 lakhs for belated return and short payment of advance tax).

6. In the case of a company in which the public were substantially interested an amount of Rs.3.76 lakhs was debited towards purchase tax in the profit and loss account for the previous year relevant to the assessment year 1982-83 (assessment completed in June 1988). However, as per the records of the sales-tax authorities purchase tax payable by the assessee was Rs.1.88 lakhs only. This, together with excess depreciation (Rs.54,343) allowed, resulted in underassessment of income of Rs.2.43 lakhs involving short levy of tax of Rs.2.88 lakhs (including interest for late filing of return of Rs.64,308 and interest for non-payment of advance tax of Rs.87,123).

Similarly, for the assessment year 1983-84 (scrutiny assessment completed in March 1989), an amount of Rs.5.96 lakhs was debited towards payment of purchase tax in the profit and loss account for the relevant previous year whereas the purchase tax payable as per the sales tax authorities was Rs.2.88 lakhs. This, together with excess depreciation (Rs.1.53 lakhs) allowed, resulted in underassessment of income of Rs.4.61 lakhs and short levy of tax of Rs.5.75 lakhs (including interest for late filing of return of Rs.91,650 and interest for non-payment of advance tax of Rs.2.23 lakhs). Thus, there was an aggregate short levy of tax (including

interest) to the extent of Rs.8.63 lakhs.

7. It has been judicially held* that an assessee who has valued the closing stock and work-in-progress taking into account the element of custom duty paid but who has charged the profit and loss account with the customs duty relatable only to the goods sold, is entitled to have the deduction, in the computation of income, of a sum which is equal to the element of customs duty embedded in the value of closing stock, since he has not debited the full amount of customs duty paid to the profit and loss account while according to the law he is entitled to the deduction on payment basis.

In the case of three assessee companies it was noticed in audit that relying on the judicial decision mentioned above, deduction to the extent of Rs.3.18 crores was allowed on account of the element of customs duty embedded in the value of closing stock, as claimed by the assessee, in their assessments for assessment year 1984-85, 1985-86 and 1986-87 completed in February 1987, March 1987, April 1987 and September 1987. It was pointed out in audit that the judicial decision relied upon was not applicable as the assessees had debited their profit and loss account with the full amount of customs duty paid on the cost of purchase and nothing more remained to be allowed on account of duties paid. The mistake resulted in under-assessment of income to the extent of the allowance granted involving short levy of tax of Rs.1.84 crores for the three assessment years.

8. Under the provisions of Income-tax Act, 1961, interest paid or payable on capital borrowed for the purpose of business is an allowable deduction. It has been judicially held that the mere fact that an assessee keeps his accounts on the mercantile system does not give him a handle to debit liability of every kind. The liability that can be debited is only that which is certain and which arises in present.

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* **162-ITR-240 Lakhanpal National Ltd. Vs. Income-tax Officer**

In the assessment of a widely held company for the assessment year 1988-89 assessed in January 1990 at a loss of Rs.1,389.54 lakhs, the assessing officer allowed a deduction of Rs.548.07 lakhs on account of interest payable on unsecured loans from Government. The relevant Tax Audit Report commented that the penal interest of Rs.85.10 lakhs included in the interest debit of Rs.548.07 lakhs should not have been provided therein as no liability for that did arise in the relevant period. It was also observed that interest should have been provided at normal rates only till such date as it attracted penal provision. The allowance of deduction on account of the penal interest of Rs.85.10 lakhs was, therefore, incorrect in view of non-accrual of the said liability during the relevant accounting period. This led to to overstatement and excess carry forward of loss of Rs.85.10 lakhs with a potential tax effect of Rs.44.68 lakhs.

9 Under the provisions of the Income-tax Act, 1961, any expenditure not being expenditure of capital nature or personal expenses of the assessee laid out or expended wholly and exclusively for the purpose of the business is allowable as deduction in computing income chargeable under the head `Profits and gains of business'

During the previous year relevant to the assessment years 1983-84 to 1986-87, a widely held company embarked on a project for manufacture of a new product. This project was transferred in December 1985 to a wholly owned subsidiary and was commissioned by the subsidiary company in July 1986 during the previous year relevant to the assessment year 1987-88. Audit scrutiny of the annual accounts of the subsidiary company relevant to the assessment year 1987-88 in September 1990 revealed that the pre-operative expenses of Rs.56.42 lakhs claimed by it included Rs.53.43 lakhs incurred by the holding company during the previous year relevant to the assessment years 1983-84 to 1986-87 and allowed in the assessments for these years as incurred on extension of the existing business. It was, therefore, pointed out that

since the new project was commissioned only by the subsidiary company, the assessment of the holding company for the assessment years 1983-84 to 1986-87 would have to be revised to withdraw the pre-operative expenses of Rs.53.43 lakhs incurred during the relevant previous years, in which case there would be additional demands for these years aggregating to Rs.30.86 lakhs.

10. The Director's report for the year 1985 of a company engaged in the business of manufacture of paper revealed that there had been no manufacturing operation done by the company during the previous year relevant to the assessment year 1986-87 due to closure of the Mills since November 1983. As no manufacturing operation was done by the company, the assessing officer disallowed the claim for raw materials written off as also 55 percent of the expenses on power and fuel in the assessment for the assessment year 1985-86. During the previous year relevant to the assessment year 1986-87, the assessee company debited in its accounts sums of Rs.32.98 lakhs and Rs.15.72 lakhs on account of raw materials written off and expenses on power and fuel respectively. Since no manufacturing operation was conducted during this year also, due to closure of the mills, the claim for raw materials written off and proportionate expenses on power and fuel should have been disallowed and added back in the assessment in assessment year 1986-87 also. It was, however, noticed in audit in January 1990 that while making the assessment for the assessment year 1986-87 in December 1988, the assessing officer omitted to disallow and add back the same. The mistake resulted in underassessment of income of Rs.41.62 lakhs (Rs.32.98 lakhs plus 55 percent of Rs.15.72 lakhs **i.e.** Rs.8.64 lakhs) with consequent excess computation and excess carry forward of loss of identical amount for the assessment year 1986-87 involving potential tax effect of Rs.24.04 lakhs.

Ministry of Finance have accepted the audit observation.

11. A widely held company filed its return

of income for the assessment year 1989-90 computing its income at Rs.2,634.15 lakhs which was accepted by the department in the intimation sent in March 1990. Audit scrutiny in July 1990 revealed that while computing the income, the company had disallowed Rs.2.71 lakhs towards travelling by its employees by taking the difference between the aggregate excess spent over and above the amount admissible under the Rules viz., Rs.57.27 lakhs in respect of certain employees and aggregate surplus available in respect of certain other employees, viz., Rs.54.56 lakhs who had spent less than the amount admissible under the Rules. As the provisions of the rules contemplate the computation of such disallowance individually in respect of each and every employee, the procedure of setting off the surplus available for certain employees against the deficit of certain others is incorrect. The mistake resulted in short disallowance of Rs.54.56 lakhs and in short levy of tax of Rs.37.81 lakhs (including additional income-tax of Rs.6.30 lakhs).

12. In the case of a public limited company contributions and donations aggregating to Rs.56.91 lakhs to various institutions were allowed as deductions in the assessments for the assessment years 1980-81 to 1983-84 made by the Inspecting Assistant Commissioner (Assessment) in September 1983, September 1984, March 1985 and March 1986 respectively. These contributions and donations are not, however, covered by any of the provisions of the Act. Hence the deduction for these contributions and donations should not have been allowed. Failure to do so resulted in underassessment of income of Rs.56.91 lakhs leading to short levy of tax of Rs.32.41 lakhs in the four assessment years in question. Besides, in the assessment year 1981-82 there is also a consequential short levy of interest of Rs.1.10 lakhs leviable for short payment of advance tax.

13. The assessee, a widely held company, was declared by the Government of West Bengal to be a relief undertaking and was provided with working capital finance towards execution of

works. The sanction order of June 1984 contained provision for repayment of principal amount only and no stipulation was made regarding interest liability on the said working capital finance. Further, the Annual Statement of Balance of Loan upto 31 March 1987 did not include any liability for interest and the same was accepted by the assessee. Accordingly, the Deputy Commissioner of Income-tax (Special Range), while completing the assessments for the assessment years 1987-88 and 1988-89 in December 1989 and January 1990, disallowed the interest liability for the said years although the assessee charged Rs.13.27 lakhs and Rs.14.10 lakhs respectively to accounts on account of the same. In disallowing the liability, the assessing officer observed, **inter alia** that the interest which had been shown payable to the Government of West Bengal was not legally enforceable liability of the company under the West Bengal Relief Undertaking Act, 1972. However, in the assessments for the assessment years 1985-86 and 1986-87 completed in February 1987 and June 1989 at Rs. NIL, interest liabilities of Rs.8.21 lakhs and Rs.11.48 lakhs respectively, as claimed by the assessee, were not disallowed. Omission to do so led to under-assessment and excess carry forward of loss of Rs.19.69 lakhs to the subsequent assessment years 1987-88 and 1988-89 with tax effect of Rs.13.43 lakhs in the two years (including interest of Rs.3.51 lakhs for short payment of advance tax in assessment year 1987-88).

14. Under the Interest-tax Act, 1974, the interest-tax payable by a scheduled bank for any assessment year is deductible from the profit and gains of the bank assessable for that assessment year.

According to the interest-tax return for the assessment year 1983-84, furnished by a nationalised bank in June 1983, the interest-tax payable was only Rs.341.21 lakhs, though it had paid advance interest-tax of Rs.366.62 lakhs. However, while completing the assessment of income for the assessment year 1983-84 in February 1986, the Inspecting

Assistant Commissioner (Assessment) allowed the deduction of advance interest paid instead of the correct amount payable. The interest tax assessment was revised in July 1990 wherein the tax payable was worked out at Rs.335.84 lakhs. The mistake resulted in under-assessment of income of Rs.30.78 lakhs involving short levy of tax of Rs.23.89 lakhs.

Ministry of Finance have accepted the audit observation.

Irregularities in allowing depreciation

Mistake in the allowance of depreciation

3.28. Under the Income-tax Act, 1961, in computing the business income of an assessee, a deduction on account of depreciation on plant and machinery or other assets is admissible at the prescribed rates provided these are owned by the assessee and used for the purpose of his business during the relevant previous year.

Depreciation on buildings and plant and machinery is calculated on their cost or written down value, as the case may be, according to the rates prescribed in the Income-tax Rules, 1962. Special rates of depreciation ranging from 15 per cent to 100 per cent are prescribed for certain specified items of machinery and plant. A general rate of 10 percent (15 percent from assessment year 1984-85) is prescribed in respect of machinery and plant for which no special rate has been prescribed.

From assessment year 1988-89, the Taxation Laws (Amendment and Miscellaneous Provisions) Act, 1986 has prescribed the same percentage of depreciation for assets falling under respective block of assets i.e. building, machinery, plant or furniture. For plant and machinery rates of depreciation are 33.33 percent and 50 percent and for building for low paid employees of industrial undertakings 20 percent as against the general rate of 5 percent for residential building and 10 percent for non-residential buildings. With the upward revision in the rates of depreciation the extra shift allowance

admissible on some items of plant and machinery has been discontinued. Assets which are eligible for 100 percent depreciation in the initial year itself will, however, continue to get this benefit.

2. A number of mistakes in the computation and application of the law regarding depreciation in the assessment of companies were noticed during test audit during the year. Some important cases are:

(i) In the assessment of 5 companies for the assessment years 1984-85 to 1987-88 assessed in 3 different Commissioners' charges between Janauary 1988 and March 1990 due to incorrect application of rates of depreciation allowance and other irregularities in the calculation of depreciation allowance, there was an aggregate excess allowance of depreciation of Rs.1,069.77 lakhs resulting in short levy of tax of Rs.744.86 lakhs in 3 major cases and excess carry forward of unabsorbed depreciation/ over computation of loss amounting to Rs.243.79 lakhs involving potential tax effect of Rs.125.55 lakhs in 2 cases.

Sr. No.	State/ Commissioner's charge/ Name of the assessee	Assessment year/ Date of assessment	Nature of mistake	Tax effect/ Financial implication (in lakhs of rupees)
01.	Maharashtra/ Bombay City II/ A	1987-88 August 1989	Allowance of depreciation on the pollution control machinery at the rate of 100 percent as against the admissible rate of 30 percent (underassessment of income of Rs.10.43 crores).	724.00 (including interest)
02.	Maharashtra/ Bombay City II/ B	1986-87 March 1989 1987-88 March 1990	Allowance of depreciation on barages and off shore supply vessels at the rate of 15 percent treating them as plant and machinery as against 10 percent applicable to vessels (underassessment of income of Rs.160.79 lakhs).	81.97 (Potential)

03.	Bihar/ Ranchi/ C	1987-88 March 1990	As per directions of C.I.T.(Appeals), internal partition was to be treated as furniture and fitting and depreciation was admissible at 10 percent. However, depreciation for the year was allowed at 100 percent (underassessment of income of Rs.22.06 lakhs).	15.85 (including interest)
04.	Maharashtra/ Bombay City II/ D	1986-87 March 1989	Grant of depreciation on ships used for the dredging purpose at the rate of 15 percent as against 7 percent resulting in excess allowance of depreciation of Rs.83 lakhs.	43.58 (Potential)
05.	West Bengal/ W.B.I/ E	1984-85 January 1988	Allowance of depreciation at the rate of 15 percent instead of 10 percent applicable to factory building and also extra depreciation for triple shift on the 'Forming building' (underassessment of income by Rs.4.71 lakhs).	5.01 (including interest and surtax)

Ministry of Finance have accepted the audit observation in two cases.

3. Under the Income-tax Act 1961, the aggregate of all deductions in respect of depreciation made under the various provisions of the Act, shall in no case exceed the actual cost of the asset to the assessee.

(i) In the income-tax assessment of a widely held company for the assessment years 1976-77 and 1977-78 initial depreciation of Rs.18.25 lakhs and Rs.3.27 lakhs were allowed on assets costing Rs.91.25 lakhs and Rs.18.86 lakhs installed and put to use during the relevant previous year. Audit scrutiny revealed (August 1990) that while calculating the depreciation admissible on these assets for assessment years 1979-80 to 1989-90, the assessing officer overlooked the initial depreciation granted in first year and allowed depreciation on the aforesaid assets at usual rates. The mistake resulted in excess allowance of depreciation of Rs.19.49 lakhs involving undercharge of tax of Rs.12.87 lakhs.

(ii) In the assessment of a widely held company, it was observed that the total of the initial depreciation and depreciation granted upto the assessment year 1985-86 exceeded the cost of the asset. Audit scrutiny (October 1990), however, revealed that the assessments for the years 1983-84 to 1985-86 were revised. But the assessment for the earlier years 1979-80 to 1982-83 were not so revised resulting in excess allowance of depreciation of Rs.10.37 lakhs and short levy of tax of Rs.7.64 lakhs (includign sur-tax).

4. It has been held judicially that the expression' used for the purpose of business' means that the asset must be used by the owner for purpose of carrying on business and earning of profits therefrom. If the assets have not at all been used for any part of the accounting year, no depreciation can be claimed.

In the assessment of a company for the assessment year 1987-88, completed in February 1989, the assessing officer disallowed investment allowance claimed on certain machineries on the ground that they were not used for the business in the relevant previous year. As the machinery was not used in business, depreciation of Rs.6.17 lakhs and extra shift depreciation of Rs.3.08 lakhs claimed on the same machinery should also have been disallowed. The omission to do so resulted in under assessment of income of Rs.9.25 lakhs with consequent short levy of tax of Rs.5.55 lakhs.

Ministry have accepted the audit observation.

5. Under the provisions of the Income-tax Act, 1961, where an assessee has acquired any asset from a country outside India for the purpose of his business or profession and in consequence of a change in the rate of exchange at any time after the acquistion of such asset, there is an increase or reduction in the liability of the assessee as expressed in Indian currency for making payment towards the whole or a part of the cost of the asset, the amount by which the

liability aforesaid is so increased or reduced during the previous year shall be added to, or as the case may be, deducted from the actual cost of the asset. But it has been clarified by the Government of India, Ministry of Law, Justice and Company Affairs in October 1984 that the benefit of addition to actual cost of assets on change in the rate of exchange of currency is admissible only at the time of actual repayment of foreign currency loans and not on outstanding balance of loans at any time. Any intermediate fluctuations in the rate of exchange not backed by actual remittance would not be relevant for this purpose.

The assessments of an assessee company for the assessment years 1986-87 and 1987-88 were completed in March 1989 and in March 1990 with a total income of Rs.650.02 lakhs and Rs.216.39 lakhs respectively. Audit scrutiny revealed that the assessee company was adjusting its fixed assets account with exchange loss by revaluing its foreign debt with reference to the difference between the rate of exchange prevailing on the closing day of the accounting year over those prevailing on the opening day of the accounting year and was debiting the differences, being the additional cost thus arrived at by way of loss on exchange, to the asset account. For the previous year relevant to the assessment years 1986-87 and 1987-88 it was noticed that the fixed assets and capital works in progress including adjustment due to change in the rate of exchange were shown by the assessee at Rs.59.78 lakhs and Rs.134.63 lakhs respectively which included Rs.34.03 lakhs and Rs.50.11 lakhs on account of increase in the company's rupee liability on the outstanding balance of foreign currency at the end of the previous years relevant to the assessment years 1986-87 and 1987-88 on which depreciation of Rs.10.79 lakhs, and Rs.22.62 lakhs was allowed erroneously in the assessments. As the above sums of Rs.34.03 lakhs and Rs.50.11 lakhs were added to the value of assets due to intermediate fluctuations in the rate of exchange and not on actual repayment of foreign currency loan,

the allowance of depreciation of Rs.10.79 lakhs and Rs.22.62 lakhs for the assessment years 1986-87 and 1987-88 was irregular and led to aggregate undercharge of tax of Rs.19.52 lakhs (including interest).

The department has accepted the audit observation.

6. Under the Income-tax Act, 1961, depreciation on building and plant and machinery is calculated on their `written down value' defined in the Act to mean the actual cost of the assets to the assessee in the case of a new asset acquired during the previous year and actual cost less depreciation (both normal and additional) allowed under the Act in the case of assets acquired in earlier years.

In the assessment of a widely held company for the assessment year 1984-85 completed in March 1987(revised in April 1987) depreciation of Rs.304.21 lakhs was allowed on the assets, after disallowing depreciation of Rs.2.10 lakhs out of total depreciation of Rs.306.31 lakhs claimed. Audit scrutiny (September 1990) revealed that the opening written down value adopted as at the first day of the previous year in the depreciation statement of Rs.306.31 lakhs for the assessment year 1984-85 in respect of building, machinery, electrical machinery and office equipements was in excess of the closing written down value of these assets as at the last day of the previous year relevant to the assessment year 1983-84 as per the statement of depreciation of Rs.475.35 lakhs allowed in the revision made for that year in June 1986. The mistake resulted in excess allowance of depreciation for the as-sessment years 1984-85 to 1989-90 aggregating to Rs.130.35 lakhs involving potential tax effect of Rs.68.43 lakhs, as there was no taxable income upto the assessment year 1989-90.

7. The Central Board of Direct Taxes clarified in March 1976 that the subsidy received from the Central Government for establishing industrial units in selected

backward areas constitute capital receipts in the hands of the recipients and as such this amount would have to be reduced from the cost of the assets for the purpose of allowing investment allowance on such assets.

In the assessment of a company for the assessment years 1987-88 and 1988-89 completed in March 1989, investment allowance of Rs.23.12 lakhs was allowed in assessment year 1987-88 on the value of new plant and machinery installed by the company during the relevant previous year. Audit scrutiny (August 1990) revealed that the assessee had received capital subsidy of Rs.25 lakhs for setting up of new unit in a backward area. However, the assessing officer while calculating investment allowance, normal depreciation and extra shift allowance, omitted to deduct the amount of subsidy from the cost of plant and machinery to ascertain `actual cost' to the assessee. The omission resulted in excess allowance of investment allowance of Rs.6.25 lakhs in the assessment year 1987-88 and depreciation of Rs.5.63 lakhs and Rs.6.46 lakhs in the above two assessment years leading to excess carry forward of unabsorbed loss of Rs.18.33 lakhs involving potential tax effect of Rs.10.54 lakhs.

Incorrect grant of additional depreciation

3.29 Under the Income-tax Act, 1961, as amended by the Finance (No,2) Act, 1980, a deduction is allowed by way of additional depreciation in respect of new plant and machinery installed after 31 March 1980 but before 1 April 1985, the additional sum being equal to one half of the normal depreciation in respect of the previous year in which such plant and machinery is installed, or if the plant and machinery is first put to use in the immediately succeeding previous year, then in respect of that previous year.

In the assessment of the limited company for the assessment year 1985-86 completed in February 1988, the assessing officer allowed depreciation of Rs.17.28 lakhs on plant and machinery though there was no proof to establish that the plant and machinery purchased were new ones. The mistake resulted

in excess computation of loss to the same extent involving notional tax effect of Rs.9.99 lakhs.

Incorrect allowance of extra shift depreciation

3.30.1 Under the Income-tax Rules, 1962, extra shift depreciation allowance is admissible in respect of certain plant and machinery upto a maximum of an amount equal to one half of the normal depreciation allowance where a concern works double shift and upto a maximum of an amount equal to the normal depreciation allowance where a concern works triple shift. The rates of depreciation were revised with effect from 2 April 1987 applicable to the assessment year 1988-89 and onwards. No extra shift allowance was allowable therafter.

In the assessment of a company for the assessment year 1988-89 completed by the Deputy commissioner of Income-tax in March 1990, triple shift allowance of Rs.27.45 lakhs equal to the amount of normal depreciation was incorrectly allowed, while no extra shift allowance was allowable from the assessment year 1988-89. The mistake resulted in allowance of excess extra shift depreciation to the extent of Rs.27.45 lakhs and overall underassessment of income of Rs.13.12 lakhs involving short levy of tax of Rs.9.85 lakhs.(including interest)

Ministry of Finance have accepted the audit observation.

2. Further, the extra shift allowance for double or triple shift working shall be calculated separately in the proportion which the number of days for which the factory worked double or triple shift bears to the normal number of working days during the previous year.

The Central Board of Direct Taxes have issued instructions in September 1970 that where a concern has worked double or triple shift, extra shift allowance may be allowed in respect of the entire plant and machinery used by the concern without making any attempt to determine the number of days for which each machinery had actually worked

double or triple shift during the relevant previous year. The Board reiterated its stand in this regard in its subsequent instructions issued in February 1985 and the Ministry of Law have also upheld this view.

(i) The assessment of a widely held company for the assessment year 1985-86 was completed by the Deputy Commissioner of Income-tax originally in March 1988 allowing extra shift allowance of Rs.16.77 lakhs in respect of heat treatment plant installed in two of the units of the company. Audit scrutiny, however, revealed that there was no information on record to show that the above units had worked extra shift during the relevant period and further no extra shift allowance was claimed in respect of other machineries installed in these units. The extra shift allowance had been claimed only in respect of heat treatment plant presumably on the plea that the working of the plant was a continous process and it remained in operation throughout the year. Since even as per Board's instruction the extra shift allowance should be allowed only on the basis of the extra shift worked by the unit as a whole and not with reference to any individual machinery, the incorrect grant of extra shift allowance in respect of heat treatment plant led to under assessment of income by Rs.16.77 lakhs and short levy of tax of Rs.9.68 lakhs for assessment year 1985-86.

(ii) A widely held company was allowed to change the previous year from calendar year to the year ending June from assessment year 1985-86. Consequently its previous year for the assessment year 1985-86 consisted of a period of six months only i.e. from 1 January 1984 to 30 June 1984. During the previous year four units of the company worked only for 153 to 155 days (all triple shifts). Under the circumstances the extra shift allowance was allowable in the proportion of 154/240 of normal allowance. Since normal depreciation allowed at full rate was Rs.79.67 lakhs, the extra shift allowance for triple shift working allowable with reference to the number of days of working worked out

to Rs.51.10 lakhs only against Rs.79.67 lakhs as allowed. The mistake resulted in underassessment of taxable income of Rs.28.56 lakhs, involving short levy of tax of Rs.16.50 lakhs.

3. No extra shift allowance is admissible in respect of certain plant and machinery specified in the depreciation taxbale in the Income-tax Rules, 1962.

(i) In the assessment of a public sector company for the assessment year 1987-88 completed in August 1989, the assessing officer allowed extra shift depreciation of Rs.35.22 lakhs on such plant and machinery as boilers, processing plants and water supply and drainages system in the assessee's township for which extra shift depreciation allowance was not admissible. The mistake resulted in under assessment of income of Rs.35.22 lakhs involving short levy of tax of Rs.24.43 lakhs (including interest).

The department has accepted the audit observation.

(ii) No extra shift allowance is admissible on wireless apparatus, office appliances, electric machines and weighing machines.

While completing the assessment of a Government company for the assessment year 1985-86 in January 1988, the assessing officer allowed extra shift allowance amounting to Rs.149.96 lakhs on communication and signalling (Rs.34.88 lakhs) power plant (Rs.113.90 lakhs) weighing bridges and marshalling yard (Rs.1.18 lakhs). As these items were covered under wireless apparatus, office appliances, electric machine and weighing machine, no extra shift allowance was admissible on these equipments. The allowance of inadmissible extra-shift allowance resulted in excess computation of loss of Rs.149.96 lakhs involving a potential tax effect of Rs.86.60 lakhs.

(iii) Extra shift allowance is also not admissible on recording equipment,

reproducing equipment, developing machine and studio lights.

In the assessment of a company for the assessment years 1986-87 and 1987-88 completed in February 1988 and March 1988, extra shift allowance of Rs.7.16 lakhs and Rs.5.03 lakhs respectively was allowed erroneously on recording, editing, dubbing equipment and accoustic installation. The mistake resulted in under assessment of income of Rs.12.19 lakhs involving a notional aggregate short levy of tax of Rs.6.90 lakhs for the two assessment years.

Ministry have accepted the audit observation.

4. It has been held by the Income-tax Appellate Tribunal at Delhi that no extra shift allowance is to be allowed in respect of assets given on lease.

The assessment of a closely held company for the assessment year 1987-88 was completed by the Deputy Commissioner of Income-tax in March 1989 and revised in May 1990 allowing extra shift allowance of Rs.3.66 lakhs, for triple shift on assets leased out to other concerns. Since only an assessee whose concern had worked multiple shift could be allowed extra shift allowance the grant of extra shift allowance to the assessee company on machinery or plant which were not used in the concern but were leased out, was not in order. The incorrect allowance resulted in excess allowance of depreciation of Rs.3.66 lakhs and short levy of tax of Rs.3.25 lakhs (including interest).

Ministry of Finance have accepted the audit observation.

Excess set off of unabsorbed depreciation

3.31.1 Under the provisions of the Income-tax Act, 1961, where for any assessment year, unabsorbed depreciation under the head `Profits and gains of business or profession' cannot be set off against any other income in the relevant year, such unabsorbed depreciation shall be carried forward to the following assessment year and shall be set off against the profits and gains of business

or profession of that year and if there is no positive income in that year, it can be carried forward to the subsequent year for set off.

(i) In the assessment of a statutory corporation for the assessment year 1985-86, originally completed in March 1988, earlier year's unabsorbed depreciation of Rs.233.37 lakhs was set off by the assessing officer against the actual claim of Rs.237.33 lakhs made by the corporation. Subsequently, however, the department calculated the amount of such unabsorbed depreciation at Rs.15.08 lakhs instead of Rs.233.37 lakhs. Accordingly, the assessment was rectified in August 1988 leaving no balance thereof for future set off. The assessment was further revised in December 1989 wherein the assessing officer by mistake allowed a further deduction of Rs.237.33 lakhs towards earlier year's depreciation, in addition to the relief allowed in appeal. The mistake resulted in excess set off of unabsorbed depreciation of Rs.237.33 lakhs resulting in under assessment of taxable income by Rs.71.20 lakhs (being 30 percent of Rs.237.33 lakhs under the restrictive provisions of the Act) and under charge of tax of Rs.61.16 lakhs (including interest) as well as excess carry forward of unabsorbed investment allowance of Rs.166.13 lakhs (being 70 percent of Rs.237.33 lakhs) having potential tax effect of Rs.95.94 lakhs.

(ii) In the original assessment of a company for the assessment year 1983-84 completed in June 1988, the business loss and unabsorbed depreciation to be carried forward were determined at Rs.8.65 lakhs and Rs.127.02 lakhs respectively. In the assessment for the assessment year 1985-86 completed in March 1988, the unabsorbed depreciation relating to the assessment year 1983-84 was adjusted to the extent of Rs.73.82 lakhs thereby reducing the unabsorbed depreciation relating to assessment year 1983-84 to Rs.53.20 lakhs. Audit scrutiny in June 1990 revealed that in the assessment for the year 1986-87 completed in March 1989 the business loss of Rs.8.65 lakhs and unabsorbed depreciation of Rs.94.50

lakhs relating to the assessment year 1983-84 were set off allowing carry forward of unabsorbed depreciation of Rs.32.52 lakhs though an amount of Rs.73.82 lakhs had already been set off in assessment year 1985-86. The mistake resulted in excess carry over of unabsorbed depreciation of assessment year 1984-85 by Rs.73.82 lakhs in the assessment year 1987-88 completed in March 1990 involving a potential tax effect of Rs.38.75 lakhs.

Ministry of Finance have accepted the audit observation.

(iii) In the assessment of a closely held company for the assessment year 1987-88 completed by Deputy Commissioner of Income-tax in February 1990, the Deputy Commissioner (Special Range) allowed set off of business loss, unabsorbed depreciation and unabsorbed investment allowance relating to assessment years 1984-85 to 1986-87 to the extent of Rs.46.64 lakhs from the income of Rs.51.69 lakhs and determined the total income at Rs.5.05 lakhs. Audit scrutiny(November 1990), however, revealed that the unabsorbed allowances remaining to be set off in assessment year 1987-88 was Rs.12.73 lakhs only (depreciation loss Rs.5.14 lakhs relating to assessment year 1985-86 unabsorbed investment allowance Rs.4.34 lakhs, Rs.0.99 lakhs and Rs.2.26 lakhs relating to assessment years 1984-85 to 1986-87 respectively). The mistake mainly arose in the assessment order for assessment year 1987-88 in which Rs.7.45 lakhs (business loss) and Rs.25.64 lakhs (depreciation loss) determined as per the revision order (May 1989) for the assessment year 1985-86 was set off besides unabsorbed investment allowance of Rs.2.26 lakhs for assessment year 1986-87. However, it was seen that the above unabsorbed allowances had already been set off/allowed in the assessment (March 1989) for 1986-87 to the extent of Rs.30.15 lakhs. The incorrect set off and omission to make consequential revision of the assessment for the assessment year 1987-88 to allow correct amount of unabsorbed depreciation and investment allowance relating to assessment

year 1984-85 as per the revision made in March 1990 and an arithmetical error in the revision for assessment year 1986-87 resulted in under-assessment of income for assessment year 1987-88 by Rs.33.91 lakhs involving a tax effect of Rs.19.58 lakhs (including interest).

Ministry have accepted the audit observation.

2. It has been judicially held that unabsorbed depreciation could be adjusted under the statute against the income from other heads where the business, are not separate and independent, but the continuance of businesses is an essential prerequisite for such an entitlement.

A closely held company engaged in the business of manufacturing of cloth upto the assessment year 1982-83 switched over to a new business of processing of grey cloth through outsiders in the assessment year 1983-84. In the revised assessment of the company for the assessment year 1985-86 during which period the assessee company's business was manufacturing carbon papers and typewriter ribbons, completed in March 1988, the Deputy Commissioner of Income-tax allowed deduction for unabsorbed depreciation and investment allowance relating to the assessment years 1976-77 to 1978-79 aggregating to Rs.10.91 lakhs. This set off of unabsorbed depreciation and investment allowance relating to a discontinued business against the income of new business in a later year which was quite separate and independent without any inter-connection whatsoever with the old business, was not in order as has been judicially held. Similar mistake in allowance of a sum of Rs.2.18 lakhs was also noticed in the assessment for the assessment year 1984-85. These mistakes resulted in under assessment of income of Rs.10.91 lakhs for the assessment year 1985-86 and Rs.2.18 lakhs for the assessment year 1984-85 involving an aggregate short levy of tax of Rs.6.88 lakhs for the two assessment years (including interest).

Incorrect computation of capital gains

3.32 Under the Income-tax Act, 1961, where the whole of the net consideration received from the transfer of a capital asset, not being a short-term capital asset, is invested in any of the `specified assets' within a period of six months after the date of transfer, the whole of the capital gain arising out of the transfer shall not be chargeable to income-tax.

In the assessment of a company for the assessment year 1986-87 completed in March 1989, the assessing officer exempted from tax, the entire consideration money of Rs.30 lakhs received by the assessee by way of sale of roof-rights, as the same was stated to have been invested in `specified assets' within a period of six months after the date of transfer of such asset. Audit scrutiny made in February 1990, however, revealed that while as per the lease deed executed in October 1984, the transfer was effected in June 1984, the consideration money was actually invested in `specified assets' only in May 1985. As the consideration money was not invested in `specified assets'within a period of six months after the date of transfer, the assessee was not entiled to any exemption from capital gains. Irregular grant of exemption of Rs.30 lakhs, therefore, resulted in an under-charge of tax of Rs.15 lakhs for the assessment year 1986-87.

Ministry of Finance have accepted the audit observation.

Income not assessed

3.33.1 Under the Income-tax Act, 1961, any expenditure or trading liability incurred for the purpose of business carried on by the assessee is allowed as a deduction in the computation of his income. Where on a subsequent date, the assessee obtained any benefit in respect of such expenditure or trading liability allowed earlier by way of remission or cessation thereof, the benefit that accrues thereby shall be deemed to be profit and gains of business or profession to be charged to income tax as the income of the previous year in which such remission or cessation takes place.

(i) A public sector company credited sums aggregating to Rs.23.09 crores in its profit and loss appropriation accounts for the previous years relevant to assessment years 1984-85 and 1985-86 as adjustment relating to prior period being liabilities no longer required in respect of interest payable against Government of India loan share which was subsequently waived. Audit scrutiny revealed that this interest had previously been charged in the respective profit and loss accounts and allowed as deductions in the assessments for the assessment years 1977-78 to 1983-84. As the interest payable to Government was waived in July 1984, the amount of Rs.23.09 crores written back (Rs.81.39 lakhs for assessment year upto 1983-84, Rs.11.14 crores for assessment year 1984-85 and Rs.11.13 crores for assessment year 1985-86) was required to be assessed as income in assessment years 1984-85 and 1985-86. Omission to do so in the assessments (including revision) made between February 1987 and March 1989, resulted in escapement of income by the identical amount and consequently excess carry forward of unabsorbed losses by Rs.23.09 crores at the end of assessment year 1985-86, involving a potential tax effect of Rs.13.23 crores.

(ii) On an appeal filed by a limited company engaged in development of mines and minerals, the Income-tax Appellate Tribunal, Jaipur, directed (January 1986) the assessing officer to decide the quantum of shortfall in removal of over burden of rock phosphate and exclude cost of work to that extent from the total income of the assessment year 1976-77 to 1979-80. The Tribunal, however, held that the assessee would be liable to income-tax in the year in which the shortfall was made good. In pursuance of the above directions of the Tribunal, the assessing officer, after ascertaining the quantum of shortfall and the cost of non-removal of over-burden for these years excluded Rs.418.83 lakhs from the taxable income in January 1989. The assessee intimated in August 1987 that the shortfall was made good in 1981-82 to 1984-85 and the details would be filed. The department failed to pursue the matter further resulting in

over computation of loss aggregating Rs.503.21 lakhs representing the cost of shortfall made good as ascertained later by the department during the assessment years 1981-82, and 1983-84 to 1985-86 there was consequent short levy of potential tax of Rs.289.07 lakhs.

Ministry of Finance have accepted the audit observation.

(iii) The assessment for the assessment year 1985-86 of a company in which public are substantially interested (nationalised from 17.12.84) was completed on a net loss of Rs.232.36 lakhs. The assessee had submitted two profit and loss accounts (1.4.84 to 16.12.84 and 17.12.84 to 31.3.85) and in the profit and loss appropriation account for the earlier period, had written back a liability of Rs.57.39 lakhs, as no longer required. The assessment was started with a net loss of Rs.171.42 lakhs as per the profit and loss account which did not include the non-existent liability mentioned above. The assessing officer, omitted to include the same in the assessment which led to underassessment of income by Rs.57.39 lakhs i.e. excess determination of loss to that extent. This led to excess carry forward of loss by an identical amount with a potential tax effect of Rs.33.14 lakhs.

The department has accepted the audit observation.

(iv) During the previous year relevant to the assessment year 1983-84 a private limited company, adopting a mercantile system of accounting received a sale-tax demand notice for Rs.13.69 lakhs relating to the assessment year 1977-78 but did not provide for the sum in the accounts and claimed the deduction separately in return. Although in the regular assessment, made in January 1985 the assessing officer omitted to allow the deduction claimed as a disputed and contingent liability, it was later allowed in the revised assessment for 1983-84 made in February 1988 as the assessee had won the point in appeal. However, in the following

accounting year relevant to the assessment year 1984-85 (assessment made in March 1987 and revised in April 1988) the sum was neither paid nor provided for as per details of the profit and loss account and notes thereto. Evidently, the assessee company discharged the unprovided sales-tax liablility (allowed separately in assessment year 1983-84) for the assessment year 1977-78 in assessment year 1984-85 by way of remission or cessation. The sum was, therefore, includible as income of the assessee in the assessment year 1984-85. Omission to do so led to under assessment of income of Rs.13.69 lakhs and short levy of tax of Rs.13.29 lakhs (including interest of Rs.3.95 lakhs) for short payment of advance tax in assessmentyear 1984-85).

The department has accepted the audit observation.

2. Under the Income-tax Act, 1961, income chargeable under the head `Profits and gains of business or profession' is computed in accordance with the method of accounting regularly employed by the assessee. Where an assessee follows mercantile system of accounting, the net profit or loss is calculated after taking into account all the income actually received as well as accrued or deemed to accrue as well as all expenditure and the liability incurred relating to the period regardless of their actual receipt or payment.

(i) An assessee company which was engaged, among others, in the processing of goods had, during the previous year relevant to assessment years 1985-86 and 1986-87, received sums of Rs.51.72 lakhs and Rs.187.09 lakhs respectively from its sister concern on account of central excise duty collected on behalf of the assessee company. The sister concern was not a licencee under the Central Excise and Salt Act, yet it collected the duty and passed it on to the assessee company. These sums were nothing but trading receipt in the hands of the sister concern and its passing over did not change the character of the receipt in the hands of the

assessee company who should have accounted for the same as such. These receipts were not accounted for as income in the books of the assessee company. The assessee was also not entitled to claim deduction on account of duty payable in view of the amended provisions of the Income-tax Act allowing the deduction on the basis of actual payment. The mistake resulted in under-assessment of income of Rs.238.80 lakhs and short levy of tax of Rs.140.62 lakhs in the two years.

(ii) In the assessment of a trading company for the assessment years 1987-88 and 1989-90 completed in March 1990 and December 1989 interest aggregating to Rs.66.97 lakhs accrued in the relevant previous year on loan advanced by it to other companies was not included in the computation of income. The assessee company followed mercantile system of accounting and under the provisions of the Act, addition was made by the assessing officer for interest accrued and not shown by the assessee in the computation of income of the previous years relevant to assessment year 1986-87 and the same was also upheld. Omission to include interest in assessment years 1987-88 and 1989-90 on accrual basis resulted in under assessment of income of Rs.66.97 lakhs. Further, interest accrued and received during the previous year aggregating to Rs.6.39 lakhs was not considered in the computation of income although no part of such interest was considered for the assessment year 1986-87. The aggregate underassessment of income of Rs.73.36 lakhs (Rs.49.55 lakhs + Rs.6.39 lakhs +Rs.17.42 lakhs) led to undercharge of tax of Rs.63.82 lakhs including interest of Rs.0.42 lakhs for belated submission of return additional tax of Rs.2.20 lakhs and Rs.16.66 lakhs for short payment of advance-tax in assessment years 1987-88 and 1989-90.

(iii) An assessee company lodged claims with the Railway under the terms of agreement amounting to Rs.273.68 lakhs being escalation of wages against which it accounted for only Rs.218.15 lakhs in the profit and loss account for the previous year relevant to assessment year 1986-87. As the assessee

company was following mercantile system of accounting, the entire amount of claim should have been credited to the profit and loss account. In the assessment completed in March 1989 the assessing officer did not add back the short accountal of receipt of Rs.55.53 lakhs on account of escalation. the omission resulted in short computation of total income of Rs.55.53 lakhs with resultant short levy of tax of Rs.36.32 lakhs (inclusive of interest).

Ministry of Finance have accepted the audit observation.

3. Under the provisions of Income-tax Act, 1961, the total income of a person for any previous year includes all income, from whatever sources derived, which is received or deemed to be received or which accrues or arises or deemed to accrue or arise during such previous year unless specifically exempted from tax by the provisions of the Act.

Statutory auditor's comments in the note below the profit and loss account for the previous year relevant to the assessment year 1986-87, in respect of a public limited company, revealed that the profit as per profit and loss account was understated by a sum of Rs.28.75 lakhs due to non-accountal of accrued interest amounting to Rs.30.96 lakhs on long term fixed deposit with schedule banks and over-statement of income by Rs.2.21 lakhs from service charges. As the assessee company was maintaining its accounts under the mercantile system, all income which accrues or arises or deemed to accrue or arise during the previous year were chargeable to tax. The assessing officer, while completing the assessment for the assessment year 1986-87 in March 1989, however, omitted to add back the understated income of Rs.28.75 lakhs, though the same was specifically pointed out by the statutory auditor. The omission resulted in under assessment of income of Rs.28.75 lakhs with consequent undercharge of tax of Rs.15.47 lakhs (including short levy of interest of Rs.37,734 for late filing of return and short

levy of sur-tax of Rs.5,46,250) for the assessment year 1986-87.

Ministry of Finance have accepted the audit observation.

4. Under the provisions of the Income-tax Act, 1961, interest is payable by Government on the amount of refund due to an assessee if the refund is not granted within the time stipulated in the Act. The interest paid by Government constitutes income of the assessee and is chargeable to tax in the assessment year relevant to the previous year in which it is paid.

During the previous year relevant to the assessment year 1987-88, a non-resident banking company received an amount of Rs.29.72 lakhs from the income-tax department on account of interest for belated grant of refund of tax as was evident from the assessment records of the company pertaining to the assessment year 1986-87. The interest of Rs.29.72 lakhs which was chargeable to tax in the assessment year 1987-88 was neither returned by the assessee nor brought to tax in the assessment made resulting in short levy of tax of Rs.19.32 lakhs.

5. A State Government undertaking which has as its object the promotion of the growth of industries in the State had also undertaken a scheme for the educated unemployed. The income and expenditure account of the scheme for the previous year relevant to the assessment year 1983-84 revealed a surplus of Rs.18.10 lakhs which was neither returned nor assessed by the department. As there is no specific provision exempting the income of the corporation from tax, its exclusion resulted in income of Rs.18.10 lakhs escaping assessment leading to notional short levy of tax of Rs.10.21 lakhs.

The department has accepted the audit observation.

6. It has been judicially held* that the

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* **Chowringhee Sales Bureau Vs. C.I.T. (97-ITR-615 - S.C.)**

amount of sales tax collected by a trader in the course of his business constitutes his trading receipts and is to be included in his total income. If and when the assessee paid the amount so collected to the State Government or refunded any part thereof to the purchaser, the assessee would be entitled to claim deduction of the sum so paid or refunded.

The assessment of a public limited company for the assessment year 1986-87 was completed in March 1989 on a loss of Rs.5.45 lakhs. It was, however, noticed in audit that sales tax collected by the assessee company during the relevant previous year and not deposited to Government account amounted to Rs.40.23 lakhs. The company did not include the amount collected towards sales tax in its profit and loss accounts. Sales tax collected being a trading receipt, the unpaid amount should have been brought to tax. The omission to do so resulted in under assessment of income by Rs.40.23 lakhs. After setting-off the assessed loss of Rs.5.45 lakhs thereagainst the total income worked out to Rs.34.78 lakhs involving tax under charge of Rs.28.30 lakhs (including interest of Rs.2.05 lakhs for belated submission of return and Rs.7.99 lakhs for non-furnishing of estimate of advance tax) for the assessment year 1986-87.

7. The Income-tax Act provides that with effect from the assessment year 1984-85, in computing the business income of an assessee, liability for any sum payable by way of tax or duty under any law for the time being in force or for any sum payable by him as an employer by way of contribution to any provident fund or superannuation or gratuity or any other fund for the welfare of the employees, will be allowed out of the income of the previous year in which such sum is actually paid irrespective of the method of accounting employed by the assessee. In other words, these deductions are admissible only on actual payment and not on accrual basis.

The assessment of a public limited company for the assessment year 1984-85 completed in January 1986 was finally revised in March

1990 to disallow a sum of Rs.38.71 lakhs being unpaid excise duty on unsold stock at the end of the previous year ended 31 March 1984 as per order of the Commissioner of Income-tax(Appeals). It was, however, seen that in the original assessment made in January 1986 a sum of Rs.10.34 lakhs was allowed as deduction after adjustment of Rs.28.37 lakhs representing unpaid sales tax, provident fund etc., against the aforesaid sum of Rs.38.71 lakhs which was claimed by the assessee company as paid. As the assessee company did not pay any sum towards sales tax and provident fund etc. by the end of the previous year and was allowed an incorrect deduction in the original assessment a further sum of Rs.38.71 lakhs (Rs.28.37 lakhs +Rs.10.34 lakhs) was disallowable in the revised assessment. Omission to do so resulted in under assessment of income of a like sum involving short levy of tax of Rs.22.35 lakhs was in the assessment year 1984-85.

8. Under the Income-tax Act, 1961 a non-resident tax payer is chargeable to tax in India on all income which is received or deemed to be received in India or which accrues or arises or deemed to accrue or arise in India. The Act further lays down that any income accruing or arising, whether directly or indirectly through or from any business connection in India, shall be deemed to accrue or arise in India. Though the term business connection has not been defined in the Act, an established tie up for supply of raw materials from abroad and manufacture in India, towards sales abroad between a resident and non-resident would indicate a business connection, as would fall within the ambit of the expression business connection'.

The assessment for the assessment year 1982-82 of a company was completed in March 1985. Audit scrutiny of the assessment records of the assessee Indian company for the assessment year 1982-83 in October 1989 disclosed that an agreement was subsisting between the assessee and a non-resident agent under which the non-resident would supply raw

materials from abroad for manufacture by the assessee of steel pipes in India towards sales to be effected in a foreign country on FOB basis, through and against orders received from the non-resident agent. In the previous year relevant to the assessment year 1982-83, the non-resident had supplied raw materials worth Rs.354.06 lakhs mainly for the supply of 8000 M.T. steel pipes to a foreign country. The assessment records revealed that the non-resident was entitled to receive a commission of 3 percent of the invoice price. This entire sum accrued to the non-resident in India who would have earned a commission of Rs.10.73 lakhs in the aforesaid transaction. Although the assessee was liable to be taxed on the income of the non-resident as the agent, no action was taken by the department. Further the assessment records revealed that in relation to another contract of similar nature for supply of steel tubes abroad, the assessee paid to the non-resident agent in November 1979 a sum of $ 99,451.95 equivalent to Rs.8.15 lakhs towards rebate and usual commission which also accrued to the non-resident in India. However, the department did not initiate any action to levy the tax. Thus, failure to initiate timely action resulted in an aggregate escapement of income of Rs.18.88 lakhs with consequent non levy of tax of Rs.13.83 lakhs.

9. Under the provisions of the Income-tax Act, 1961, where in the financial year immediately preceding the assessment year the assessee has made investmment which are not recorded in the books of account, if any, maintained by him for any source of income, and the assessee offers no explanation about the nature and source of investments or the explanation offered by him is not, in the opinion of the assessing officer, satisfactory, the value of the investments may be deemed to be the income of the assessee of such financial year.

In completing the assessment of a private limited company for the assessment year 1986-87 on 31 March 1989, the assessing officer found unexplained investment of Rs.9.99 lakhs in the previous year relevant to the

assessment year 1984-85. Although the unexplained investment for the assessment year 1984-85 was recorded in the assessment order for the assessment year 1986-87, no action was initiated (till the date of audit 26 June 1990) to include the said income in the assessment year 1984-85 resulting in non-raising of demand of tax of Rs.8.68 lakhs (inclusive of interest of Rs.2.29,680 for non-payment of advance tax).

The assessing officer stated that the remedial action was being taken for the assessment year 1984-85.

10. The Central Board of Direct Taxes issued instructions in February 1986 stating that cash compensatory support given to exporters is taxable as trading receipt. The Finance Act,1990 also amended the Income-tax Act with retrospective effect from the assessment year 1967-68 that the export incentive given to exporters by way of cash compensatory support or any other subsidy received by them for export will be included in the definition of income and taxed under the head `Profits and gains of business or profession'.

In the income-tax assessments of a widely held company for the assessment years 1985-86 and 1986-87 made in March 1988 and March 1989, cash compensatory support on export amounting to Rs.32.84 lakhs and Rs.31.43 lakhs, claimed as capital receipts were assessed as trading receipts. However, with reference to the directions issued by the Commissioner of Income-tax (Appeals) in August 1988 and July 1989 the assessments for these years were revised in September 1988 and July 1989 reducing the income for these years by Rs.32.84 lakhs and Rs.31.43 lakhs respectively. As the above amounts are taxable as trading receipts as per Board's instructions cited and the amended provisions of the Act, it was pointed out in audit in September 1990, that the Commissioner of Income-tax (Appeals) would have to be requested to revise the orders issued earlier in August 1988 and July 1989 for assessing the sums of Rs.32.84 lakhs and Rs.31.43 lakhs as trading receipts for the assessment years

1985-86 and 1986-87 respectively in which case the aggregate additional demand for these years would be Rs.43.98 lakhs.

Incorrect set off and carry forward of losses

3.34.1. No loss under the head `Profits and gains of business or profession' is allowed to be carried forward from 1 April 1985 for set off unless the assessee has filed the return of loss voluntarily within the due date or within such further time as may be allowed by the assessing officer.

(i) In the case of a State Government company the return of business loss of Rs.30.14 crores was filed by it for the assessment year 1986-87 on 31 October 1986 against the due date of 31 July 1986. There was no evidence of either the company having applied for or having been granted extension of time for filing it. However, the loss of Rs.1,389.03 lakhs determined by the Deputy Commissioner of Income-tax (Special Range) in February 1989 in a scrutiny assessment, was ordered to be carried forward. The mistake resulted in potential short levy of tax of Rs.729.24 lakhs.

The department has accepted the audit observation.

(ii) An assessee company filed its return of loss of Rs.140.58 lakhs for the assessment year 1988-89 on 29 July 1988 against the due date of 30 June 1988 without seeking extension of time. The business loss was assessed at Rs.107.91 lakhs which was allowed to be carried forward against future profits. As the return of loss was filed beyond the prescribed date, the benefit of carry forward of loss was not admissible to the assessee company. The mistake resulted in erroneous carry forward of loss involving potential tax effect of Rs.62.32 lakhs.

Ministry of Finance have accepted the audit observation.

(iii) In the case of three companies, returns of the losses for the assessment years 1989-90, 1988-89 and 1985-86 were furnished on 1 January 1990, 30 June 1989 and

30 September 1985 against the due dates of 29 December 1989, 31 July 1988 and 30 June 1985 respectively. Though no extension of time was sought for or allowed in the latter two cases, business losses of Rs.20.31 lakhs, Rs.15.68 lakhs and Rs.6.83 lakhs were allowed to be carried forward for set off in the assessments completed in March 1990. The mistake resulted in potential short levy of tax aggregating to Rs.25.08 lakhs.

Ministry of Finance have accepted the audit observation in two cases.

2. Under the provision of the Income-tax Act, 1961, while computing the business income of any assessment year deduction towards depreciation for that year shall be allowed before setting off the unabsorbed loss of earlier years. Further unlike the unabsorbed business loss which shall not be carried forward for more than eight assessment years immediately succeeding the assessment year for which the loss was computed, unabsorbed depreciation shall be carried forward without any time limit.

While completing the assessment of a company for the assessment year 1986-87 in February 1989, unabsorbed loss of Rs.7.05 crores relating to the assessment years 1981-82 and 1985-86 was allowed to be set off against the income of Rs.5.28 crores before allowing the deduction of Rs.7.59 crores towards depreciation admissible for the assessment year 1986-87. Irregular set off of unabsorbed business loss before allowing the deduction towards depreciation resulted in erroneous carry forward of Rs.5.28 crores as unabsorbed depreciation instead of as unabsorbed loss. As the benefit of indefinite carry forward of unabsorbed depreciation is not available to unabsorbed business loss which gets lapsed after eight years, the above mistake was fraught with the risk of a possible short levy involving a potential tax effect upto Rs.2.77 crores.

Ministry of Finance have accepted the audit observation.

3. Under the Income-tax Act, 1961, where for any assessment year, the unabsorbed depreciation and investment allowance under the head `Profits and gains of business or profession' cannot be set off or is not wholly set off against any other income of the relevant year such unabsorbed depreciation and investment allowance shall be carried forward to the following year and is set off against the profits or gains of any other business or profession.

In the assessment of a company for the assessment year 1987-88, completed in January 1990, unabsorbed depreciation and investment allowance aggregating to Rs.254.22 lakhs pertaining to the assessment year 1983-84, was allowed to be carried forward for set off, as against the deduction worked out at Rs.237.75 lakhs in the revisionary order of assessment for the assessment year 1986-87 passed in October 1989. However, loss for the assessment year 1983-84 as determined in the latest revision made in August 1988 was Rs.294.24 lakhs and after deducting set off of Rs.76.14 lakhs, as allowed in the revisionary order of assessment of October 1989, the loss remaining to be carried forward for set off was Rs.218.10 lakhs. Thus, excess loss of Rs.36.12 lakhs was allowed to be carried forward for set off which resulted in potential short levy of tax of Rs.18.06 lakhs.

4.(i) In the rectificatory order passed in the assessment of a company for the assessment year 1986-87, in December 1989, unabsorbed loss relating to the assessment year 1985-86 to be carried forward was shown as Rs.618.38 lakhs as against the correct amount of Rs.441.05 lakhs. This mistake resulted in excess carry forward of loss of Rs.177.33 lakhs involving a potential tax effect of Rs.93.10 lakhs.

Ministry of Finance have accepted the audit observation.

(ii) In the assessment of a company for the assessment year 1986-87, completed in January 1989, a sum of Rs.36.08 lakhs, disallowed in

the assessment year 1985-86 under the above provisions of the Act, was allowed as deduction. Of this, an amount of Rs.33.15 lakhs was later (May 1989) ordered by the Commissioner of Income-tax (Appeals) to be allowed as deduction in the assessment year 1985-86 itself. The assessment for the assessment year 1985-86 was, accordingly, revised by the Deputy Commissioner (Assessment) in June 1989 to give effect to the appellate order. However, the assessment for the assessment year 1986-87 was not simultaneously revised to withdraw the excess deduction already allowed. The omission resulted in excess carry forward of loss of Rs.33.15 lakhs, with a potential tax effect of Rs.17.40 lakhs.

Ministry of Finance have accepted the audit observation.

(iii) In the assessment of two companies for the assessment years 1984-85 and 1985-86 (assessment made in March 1987 and January 1988) (revised in March 1988) the total income assessed at Rs.38.27 lakhs and Rs.10.49 lakhs comprising income from house property of Rs.15.85 lakhs and Rs.4.07 lakhs and business income of Rs.22.42 lakhs and Rs.6.42 lakhs respectively, was fully set off against the business loss carried forward from earlier years and the assessment year 1983-84. As unabsorbed business loss of earlier years could be set off only against the business income of later year or years, the set off of earlier year's business loss aggregating to Rs.25.53 lakhs against the current year's income from house property was irregular. The mistake led to underassessment of income of Rs.19.11 lakhs and non-levy fo tax of Rs.16.06 lakhs including interest of Rs.14,153 for belated submission of return and Rs.4.72 lakhs for non payment of advance tax in assessment years 1984-85 and 1985-86.

The department has accepted the audit observation.

5. Under the Income-tax Act, 1961, no carry over of the business loss will be available

beyond eight assessment years including the assessment year in which the loss occurred.

(i) In the assessment of a company for assessment year 1987-88 completed in August 1989, carried forward business losses to the extent of Rs.29.99 lakhs were set off against its income of Rs.44.38 lakhs for that year. Audit scrutiny revealed that the losses in question were carried forward from assessment year 1973-74 to 1978-79. As more than eight years had elapsed from the assessment years in which the losses in question occurred, set off of the losses allowed was not in order. The mistake resulted in underassessment of income by Rs.29.99 lakhs leading to short levy of tax of Rs.15 lakhs.

(ii) In the case of a public limited company, the loss for the assessment year 1976-77, as determined in the assessment made in October 1984, was Rs.46.72 lakhs. After set off of Rs.25.04 lakhs against the profits for the assessment years 1978-79 and 1979-80, the balance of Rs.21.68 lakhs remained to be set off against which set off of Rs.30.83 lakhs was allowed in the assessment for the assessment year 1980-81 made by the Deputy Commissioner of Income-tax (Asstt.) in March 1989. The mistake resulted in excess set off of Rs.9.15 lakhs involving short levy of tax of Rs.9.48 lakhs (including interest of Rs.4.07 lakhs for default in payment of advance tax).

Similarly, loss of Rs.11.64 lakhs for the assessment year 1977-78 was determined in the assessment made in February 1988, out of which, after set off of loss of Rs.11.02 lakhs against profit for the assessment year 1980-81, balance of Rs.61,855 was set off against the profit for the assessment year 1981-82. However, in the revisionary assessment for the assessment year 1980-81 made in March 1989, the entire loss of Rs.11.64 lakhs pertaining to the assessment year 1977-78 was set off against the profit for the assessment year 1980-81. No consequential revision in the assessment for the assessment year 1981-82 was made to withdraw set off of Rs.61,855 allowed

earlier. This resulted in short levy of tax of Rs.65,132 including interest of Rs.28,561 for default in payment of advance tax.

The total excess set off of losses of Rs.9.77 lakhs (Rs.9.15 lakhs plus Rs.0.62 lakh) resulted in short levy of tax and interest aggregating to Rs.10.13 lakhs.

Mistakes in assessments while giving effect to appellate orders

3.35 Under the Income-tax Act, 1961, an assessee who is aggrieved can appeal to the Commissioner of Income-tax (Appeals), against an order of assessment made by the Income-tax Officer and the latter shall comply with the directions given by the Commissioner of Income-tax (Appeals) in the appellate order. Similar appeals lie to the Appellate Tribunal, High Court and Supreme Court.

As in earlier years, a number of mistakes in the assessments while giving effect to the appellate orders were noticed. 9 representative cases are given below:

1. The regular assessment of an assessee company for the assessment year 1980-81 was originally completed in March 1984 on a total income of Rs.5.86 crores wherein a provision for contigent liability amounting to Rs.1.88 crores was allowed by the assessing officer. It was held in audit (November 1984) that the above provision had been incorrectly allowed and the case was reported in Para 4(23)(i) of the Audit Report for the year ending 31 March 1987. The Ministry of Finance had also accepted the mistake and in consequance the original assessment was rectified in the assessment framed in March 1988 by withdrawing the contingent liability of Rs.1.88 crores. It was, however, noticed in audit (October 1989) that while revising the assessment in June 1989 in pursuance of a subsequent appellate order the aforesaid amount of provision of Rs.1.88 crores was again allowed as relief, though this point was not covered by the appellate orders. The mistake resulted in escapement of income by Rs.1.88 crores in the assessment year 1980-81 involving undercharge of tax of Rs.1.63 crores including excess interest of Rs. 52.22

lakhs paid to the assessee for excess payment of advance tax.

2. In the assessment of a company for the assessment year 1986-87 completed by the Deputy Commissioner of Income-tax (Special Range) in March 1989, a deduction of Rs.37.71 lakhs was allowed being sales tax liability disallowed in the assessment of the assessment year 1985-86. It was seen in audit that though in the original order for the assessment year 1985-86, the assessing officer had disallowed the outstanding sales-tax liability of Rs.37.71 lakhs, on appeal, the Commissioner of Income-tax (Appeal) had allowed an amount of Rs.28.24 lakhs out of Rs.37.71 lakhs. The assessing officer had also given effect to the appellate orders in March 1990. Therefore, the deduction allowed in the assessment year 1986-87 should have been withdrawn to the extent of Rs.28.24 lakhs which was not done.

Similarly, in the assessment for the assessment year 1987-88 completed in March 1990, a deduction of Rs.167.73 lakhs was allowed being unpaid sales-tax liability disallowed during the assessment years 1985-86 and 1986-87. The assessment for the assessment year 1986-87 underwent revision in March 1990 to give effect to Commissioner of Income-tax (Appeals) orders in which the addition of Rs.64.91 lakhs out of Rs.167.73 lakhs earlier disallowed was allowed. In view of the relief allowed, the deduction allowed in the assessment year 1987-88 should also have withdrawn to the extent of Rs.64.91 lakhs which was not done. The above mistakes resulted in underassessment of income of Rs.93.15 lakhs (Rs.28.24 lakhs in the assessment year 1986-87 and Rs.64.91 lakhs in the assessment year 1987-88) leading to aggregate short levy of tax of Rs.69.34 lakhs.

3. A company had procured long term loans for modernisation of its cement plants. During the previous year relevant to the assessment year 1983-84, the company paid Rs.1,891.19 lakhs on account of interest towards the long term loans. Out of this an

amount of Rs.1,002.21 lakhs was debited to the profit and loss account as revenue expenditure and Rs.888.98 lakhs was treated as capital expenditure. The company claimed depreciation on such capitalised expenditure which was allowed. The assessee company also claimed the interest capitalised as revenue expenditure treating it as interest on borrowed capital. This was, however, not accepted by the assessing officer. On an appeal by the company, the Commissioner of Income-tax (Appeals) admitted the company's claim and allowed the amount capitalised as revenue expenditure. The appellate order was given effect and the assessment was rectifed on 31 March 1986, allowing the claim as revenue expenditure. The assessing officer, however, omitted to withdraw the depreciation already allowed on the amount when it was capitalised. In the absence of the details regarding the interest capitalised and allocated to the various assets, it was pointed out in audit (January 1987) that approximately depreciation of Rs.88.90 lakhs was required to be withdrawn.

The department has accepted the audit observation to the extent of Rs.649.70 lakhs as against Rs.888.98 lakhs pointed out in audit and has withdrawn depreciation of Rs.91.32 lakhs creating additional demand of Rs.51.48 lakhs.

4. In the case of a nationalised bank, the assessee's claim for export market allowance in respect of its overseas branch was disallowed in its regular assessment for the assessment years 1979-80 and 1980-81, completed in September 1982. On the assessee's claim for the assessment year 1979-80 being unpheld in principle in appeal, the deduction of Rs.10.40 lakhs claimed in the return was allowed in full without restricting the same to actual quantum of Rs.7.63 lakhs admissible under the Act. For the assessment year 1980-81, although the amount of similar relief quantified in the return Rs.46.76 lakhs was allowed in appeal, deduction allowable on the basis of the data furnished in the accompanying accounts was to the extent of Rs.9.08 lakhs only. The excess

deduction arose due to erroneous inclusion of interest charges on deposits with the overseas branch as an item of allowable expenditure for the relief. This led to excess relief of Rs.2.77 lakhs and Rs.37.68 lakhs for the assessment years 1979-80 and 1980-81 respectively and consequent short levy of tax aggregating Rs.23.88 lakhs. Although the amendments to give effect to the appellate orders relating to assessment years 1979-80 and 1980-81 had been made in May 1983 and June 1984 respectively, the aforesaid mistake, was not detected by the department. The relevant assessment records were produced for audit only in May 1989, when the omissions were pointed out. Meanwhile, the rectification of the mistakes had become barred by time.

5. The assessment of a widely held company for the assessment year 1984-85 was completed in March 1987 making an addition of Rs.34.98 lakhs towards interest on accrual basis and allowing a deduction of Rs.36.72 lakhs on account of interest relating to the assessment year 1983-84 assessed on accrual basis. Thus, a net deduction of Rs.1.74 lakhs was allowed in the assessment for assessment year 1984-85. On an appeal preferred by the assessee, the Commissioner of Income-tax (Appeals) held that the interest of Rs.34.98 lakhs was not liable to be taxed in assessment year 1984-85 on accrual basis. In the revision made for the assessment year 1984-85 in February 1988 to give effect to appellate orders, the department allowed a deduction of Rs.34.98 lakhs representing the accrued interest for assessment year 1984-85 without adding back Rs.36.72 lakhs being the accrued interest to assessment year 1983-84 already deducted in the original assessment, eventhough the addition of Rs.36.72 lakhs made in the assessment for the assessment year 1983-84 was already deleted by the Commissioner of Income-tax (Appeals). To rectify the mistake, a notice was issued in February 1988 and the assessee company objected in March 1988 to the department's proposal. It was noticed in audit in November 1989 that no further action was taken to add back the deduction of Rs.36.72 lakhs and the

pendency was also not watched through the register prescribed for the purpose.

On being pointed out by audit the department has revised the assessment in June 1990 raising an additional demand of Rs.30.38 lakhs including a sum of Rs.19.17 lakhs towards interest for belated filing of return and for failure to file estimate of advance tax.

6. The assessment of a company for the assessment year 1984-85 was rectified in March 1989 for giving effect to the orders of Commissioner of Income-tax (Appeals). In the revised assessment the assessing officer, due to an arithmatical error determined the taxable income at Rs.391.71 lakhs as against the correct amount of Rs.401.71 lakhs. This mistake resulted in underassessment of income of Rs.10 lakhs leading to short levy of tax of Rs.9.01 lakhs including interest leviable for short payment of advance tax.

The department has accepted the audit observation.

7. The assessments of a company for the assessment years 1985-86 and 1986-87 were completed in March 1988 and December 1988 respectively, by the Deputy Commissioner (Special Range). The assessing officer allowed a deduction of Rs.7.13 lakhs in both the assessment years towards the second and the third instalment of the initial contribution to superannuation fund calculated on the basis of the original assessment completed for the assessment year 1984-85. It was, however, seen in audit that the entire initial contribution made in the previous year relevant to the assessment year 1984-85 was allowed as deduction under appellate orders. Hence, the deduction of Rs.7.13 lakhs allowed towards the second and the third instalment in the assessment years 1985-86 and 1986-87 were required to be withdrawn which was not done. The omission resulted in underassessment of income of Rs.7.13 lakhs in each of the assessment years 1985-86 and 1986-87 involving aggregate short levy of tax of Rs.8.24 lakhs.

The department has accepted the audit observation.

8. In the previous year relevant to the assessment year 1986-87, a closely held company incurred expenditure of Rs.37.88 lakhs on ring frames and Rs.1.55 lakhs on guarantee commission. While completing the assessment in March 1989, the assessing officer did not allow this deduction as revenue expenditure in computing taxable income but allowed depreciation of Rs.8.28 lakhs on these items for the assessment year 1987-88 in the assessment completed in September 1989. On appeal by the assessee company, the Commissioner of Income-tax (Appeals) allowed the entire expenditure as revenue expenditure for the assessment year 1986-87. While giving effect to the appellate orders in October 1989, the entire expenditure was allowed as deduction and the depreciation allowed for assessment year 1986-87 was withdrawn. Audit scrutiny in July 1990, however, revealed that the depreciation of Rs.8.28 lakhs allowed earlier for assessment year 1987-88 was not withdrawn. The omission resulted in short levy of tax of Rs.6.32 lakhs (including interest for belated filing of return and short payment of advance tax).

The department has accepted the observation.

9. The assessment of a tea company for the assessment year 1987-88 was completed in March 1990 and revised in April 1990 determining the composite income at Rs.237.52 lakhs after allowing rebate of Rs.47.50 lakhs in respect of investment deposit account. In appeal, the Commissioner of Income-tax (Appeals) directed to deduct export market development allowance of Rs.8 lakhs from the composite income and also deleted addition of Rs.69.08 lakhs made on closing stock. The assessment was modified in December 1990 giving effect to appellate orders and reducing the composite income by Rs.77.08 lakhs. Consequently, rebate under investment deposit account at the rate of 20 percent of the profit was to be reduced by Rs.15.42 lakhs, which was lost sight of in assessment,

leading to undercharge of tax of Rs.4.11 lakhs including interest of Rs.1.03 lakhs for short payment of advance tax.

Incorrect exemptions and excess reliefs

Mistake in allowing deduction under Chapter VIA

3.36.1 Under the provisions of Chapter VI A of the Income-tax Act, 1961, certain deductions are admissible from the gross total income of an assessee in arriving at the net income chargeable to tax. The overriding condition is that the total deduction should not exceed the gross total income of the assessee. The gross total income' has been defined in the Act as the total income computed in accordance with the provision of the Act before making the deductions under Chapter VI A. Where the set off of unabsorbed loss, depreciation, investment allowance etc., of earlier years results in reducing the total income to nil' or to a loss, no deduction under Chapter VIA is admissible.

The assessment of a company for the assessment year 1984-85 was revised in March 1989 to give effect to appellate orders and the gross total income was computed as Rs.12.26 lakhs. Accordingly the deduction allowable under Chapter VIA was allowable only to the extent of Rs.12.26 lakhs. However, the Deputy Commissioner of Income-tax (Special Range) allowed the deduction under Chapter VIA aggregating to Rs.19.65 lakhs without restricting it to the gross total income. The mistake resulted in incorrect carry forward of Rs.7.39 lakhs as unabsorbed deduction involving a potential short levy of tax of Rs.6.66 lakhs (including interest for the late filing of return and interest for short payment of advance tax).

Ministry of Finance have accepted the audit observation.

2. An assessee company established a new unit of 100 percent export oriented industrial undertaking in a backward area prior to 31 March 1981. In the assessment of the company for the assessment year 1986-87 (completed in March 1989 and revised in

Setpember 1989 and in September 1990) the assessing officer allowed a deduction of Rs.3.66 lakhs towards profit from newly established industrial undertaking in backward area and Rs.9.15 lakhs towards export turnover in respect of the said unit on the basis of gross total income of Rs.18.30 lakhs earned by the unit during the relevant previous year. In addition, the assessing officer also allowed a deduction of R.14.64 lakhs towards relief in respect of profits from a new industrial undertaking against the available balance of Rs.5.49 lakhs [Rs.18.30 lakhs - (Rs.3.66 lakhs plus Rs.9.15 lakhs)] for the purpose. The omission to restrict the deduction under Chapter VIA to the gross total income for the assessment year 1986-87 resulted in the grant of excess relief by Rs.9.15 lakhs (Rs.14.64 lakhs minus Rs.5.49 lakhs) involving undercharge of tax of Rs.4.81 lakhs.

3. In the assessment of a company for the assessment years 1986-87 and 1987-88, made in February 1988 and March 1988 by the Deputy Commissioner of Income-tax (Assessment), the total deductions of Chapter VIA allowed within 70 percent of the pre-incentive income and the unabsorbed deductions of Chapter VIA allowed to be carried forward was in excess of the gross total income of the assessee. In the assessment year 1986-87 the pre-incentive income was Rs.16.34 lakhs. After allowing deduction to the extent of 70 percent amounting to Rs.11.44 lakhs, the maximum unabsorbed deduction which could be carried forward was Rs.4.90 lakhs against which deduction of Rs.8.50 lakhs was carried forward which included unabsorbed deduction of Rs.3.60 lakhs pertaining to the assessment year 1986-87 which had already merged with and formed part of the deduction for the current year. Again in the assessment year 1987-88, the pre-incentive income was Rs.22.01 lakhs. After allowing deduction to the extent of 70 percent amounting to Rs.15.40 lakhs, the maximum unabsorbed deduction which could be carried forward was Rs.6.60 lakhs as against which deduction of Rs.15.10 lakhs was carried forward which included unabsorbed deductions of assessment

years 1985-86 and 1986-87 of Rs.3.60 lakhs and Rs.4.90 lakhs respectively which had already merged with and formed part of the deduction for the current year. Thus excess carry forward of deductions at the end of assessment year 1987-88 was Rs.8.50 lakhs which resulted in potential short levy of tax of Rs.4.68 lakhs.

The department has accepted the audit observation.

4. In the assessment of a limited company, a new industrial undertaking established in backward area after March 1981, for the assessment year 1985-86, completed in March 1988, unabsorbed depreciation relating to earlier years amounting to Rs.6.18 lakhs was not deducted from the gross amount of income before calculating admissible amount of deductions under the provisions of Chapter VIA of the Act. Omission to do so resulted in under-computation of income by Rs.2.78 lakhs short levy of tax of Rs.2.61 lakhs (including interest).

Ministry of Finance have accepted the audit observation.

Incorrect deduction in respect of profits and gains from newly established industrial undertaking in backward areas

3.37.1 Under the provisions of Income-tax Act, 1961, where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking in backward area, a deduction of an amount equal to twenty per cent of the profits is allowed while computing its business income.

In the assessments of a Government company for the assessment years 1983-84 and 1984-85 (assessments completed in January 1986 and revised in September 1986 and March 1987), the Dy.Commissioner of Income Tax (Special Range) wrongly allowed deduction of Rs.23.56 lakhs and Rs.22.65 lakhs respectively in respect of profits and gains from newly industrial undertaking in backward areas. As the assessee company was engaged in project execution and not in production of articles, the assessee company was not entitled to

deduction admissible to new industrial undertaking. The incorrect allowance of deduction aggregating to Rs.46.21 lakhs resulted in under assessment of income by the same amount involving short levy of tax of Rs.39.06 lakhs (including interest of Rs.1.58 lakhs and Rs.10.91 lakhs leviable under section 139(8) and 215/217 of the Act respectively).

The department has accepted the audit observation.

2. In the case of an assessee company engaged in the sale of paper, vanaspati, caustic soda, chlorine, hydrochloric acid and other chemicals, the Deputy Commissioner of Income-tax (Special Range) in the assessment for assessment year 1984-85 completed in March 1987 on a total income of Rs.88.61 lakhs allowed a deduction of Rs.17.72 lakhs being twenty percent thereof towards profits and gains derived on its `power plant'. It was seen in audit, that because of erratic power supply, the company had to fall back on its own power plant for producing power used in company's other divisions. The company was not as such engaged in the sale of electric power and the power produced was not for the purposes of the business of the industrial undertaking. The `power plant' was a standby captive plant and power produced was entirely used by the company itself for production of articles. As there was no real or notional sale in the commercial sense, there could not be any profit on sale and hence no deduction was allowable. Moreover, generation of power does not amount to manufacture or production of an article. The incorrect allowance of Rs.17.72 lakhs resulted in underassessment of income to that extent involving short levy of tax of Rs.14.56 lakhs (inclusive of interest for short payment of advance tax).

Incorrect deduction in respect of profits and gains from newly established industrial undertakings in certain areas.

3.38 Under the provisions of the Income-tax Act, 1961, as applicable to the assessment year 1987-88, certain deductions from profits and gains of a priority industrial undertaking are available such as:

(a) a deduction equal to twenty percent of the profits of eligible business in accordance with the Investment Deposit Scheme, 1986, and

(b) a deduction in the case of a company assessee to the extent of twenty five percent of such profits, if the new industrial undertaking goes into production after 31 March 1981.

The Act also provides for these deductions to a non-priority industry, if it is a small scale unit. Further, a small scale industrial unit newly established in specified areas is eligible for a further deduction equal to twenty percent of profits and gains derived from such small scale industrial undertaking. An industrial undertaking shall be deemed to be a small scale industrial undertaking if the aggregate value of machinery and plant as on the last day of the previous year for the purpose of the business of the undertaking does not exceed thirty five lakhs of rupees.

In the assessment of a closely held company for the assessment year 1987-88, deductions aggregating to Rs.1.95 crores were allowed under the aforesaid provisions, treating the company as a small scale industrial undertaking. The company was engaged in the business of manufacture and sale of popular brand of soft drinks and aerated waters covered by item 5 of Eleventh Schedule to the Income-tax Act and was not otherwise entitled to these deductions. In order to avail of these deductions admissible to small scale industrial undertakings, the assessee claimed that its manufacturing operations were carried out in five separate units located at Ahmedabad, New Delhi, Baroda, Chittoor (Andhra Pradesh) and Bangalore. As the Branches located in these places were integral parts of a single company enterprise

with the management, control and financial arrangement, vested in it, it was incorrect to consider these units as separate industrial undertakings mainly on the basis of their location. There was also nothing on record to indicate that these units were registered as separate small scale industrial units. The total cost of plant and machinery as on the last day of the previous year (1986) was Rs.42.45 lakhs **i.e.,** beyond the prescribed limit of rupees thirty five lakhs. The assessee company itself is a hundred percent subsidiary of another company belonging to a large industrial group and it is inconceivable that the assessee company could be considered as a small scale industrial undertaking. Further, size of reserves and surplus (Rs.791 lakhs), investment (Rs.373 lakhs), sales turnover (Rs.1,132 lakhs), net profit (Rs.382 lakhs) etc., disclosed by the company's accounts for the relevant previous year, all suggest that the assessee is a large established company, high profit, non-priority industry. In view of the above, the assessee company could not have been treated as small scale industrial undertaking. Irregular grant of deductions amounting to Rs.1.95 crores from the taxable income for the assessment year 1987-88, therefore, resulted in short levy of tax of Rs.1.27 crores (including surtax of Rs.19.36 lakhs).

Without prejudice to the audit observation, there was excess computation of deduction of Rs.5.30 lakhs under investment deposit scheme (due to allowance of such deduction against non-business income) and of Rs.52.55 lakhs relating to profits and gains of newly established industrial undertaking (due to mistakes in computation) resulting in short levy of tax of Rs.38.98 lakhs (including surtax).

Incorrect allowance of deduction in respect of profit and gains from newly established industrial undertaking after certain date.

3.39.1. Under the Income-tax Act, 1961, where the gross total income of an assessee included any profit and gains derived from a newly established undertaking which went into production after 31 March 1981, the assessee is entitled to a deduction of 25 percent of such profits provided the industrial undertaking does not manufacture or produce any article or thing specified in the Eleventh Schedule. One of the items included in the Eleventh Schedule (as it existed before 1 April 1988) is machinery used in offices, shops, factories, etc. for data processing. As such an industrial undertaking engaged in the businessof data processing is not entitled to the aforesaid deduction.

(i) A company claimed deduction of Rs.18.02 lakhs and Rs.3.43 lakhs for assessment years 1984-85 and 1985-86 respectively under the above mentioned provision. The claims were allowed by the assessing officer in the assessments completed in March 1985 and December 1985 respectively and were carried forward as unabsorbed deductions for set off against income in future years under a restrictive provision applicable to companies from assessment year 1984-85. It was seen in audit that the new industrial undertaking in respect of which the deductions were claimed was engaged only in data processing on computers. As data processing is included in the Eleventh Schedule and as the unit in question was not a small scale undertaking, the assessee was not entitled to the deduction allowed by the assessing officer. The irregular allowance resulted in potential short levy of tax aggregating to Rs.13.51 lakhs in both the years.

The department has accepted the audit observation for assessment year 1985-86.

(ii) While completing the assessment of a Government company engaged in construction activities for the assessment years 1983-84 and 1984-85 in March 1986 and March 1987 respectively, the Deputy Commissioner (Assessment) erroneously allowed a deduction of Rs.6.98 lakhs for the assessment year 1983-84 and Rs.7.19 lakhs for the assessment

year 1984-85 on account of profits and gains from industrial undertakings. As the assessee company was not engaged in any manufacturing activity, the deduction allowed by the assessing officer was not in order. The mistake resulted in underassessment of income of Rs.14.17 lakhs involving tax effect of Rs.11.93 lakhs (including interest of Rs.0.49 lakh and Rs.3.35 lakhs under Section 139(8) and 215 of the Act respectively.

The department has accepted the audit observation.

(iii) In the assessment of a company engaged in the business of mining of ores and marketing them, for the assessment year 1986-87 completed in August 1988, the assessing officer allowed a deduction of Rs.11.61 lakhs at 25 percent on the profit of Rs.46.46 lakhs relating to its `granite project'. As the assessee company was only processing `granite slabs' and not manufacturing or producing them, the aforesaid deduction towards tax holiday was not admissible. The incorrect deduction allowed resulted in underassessment of income of Rs.11.61 lakhs involving a short levy of tax of Rs.9.40 lakhs (including interest of Rs.3.23 lakhs for short payment of advance tax and Rs.7,621 for belated filing of return).

The department has accepted the audit observation.

2. It has been judicially held* that the use of the term `derived from' in the relevant provisions of the Act indicate the restricted meaning given by the legislature to cover only the profits and gains directly accruing from the conduct of the business undertaking.

The assessment of a closely held company for the assessment years 1985-86 and 1986-87 were revised/completed in March 1990/March 1989 allowing deductions of Rs.7.80 lakhs/Rs.1.51 lakhs towards relief in respect of profits

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* **113 ITR 84 (SC) Cambay Electric Supply Industrial Co. Ltd. Vs CIT Gujarat II and 150 ITR 292 (Karnataka) Sterling Foods Vs CIT Karnataka**

and gains from industrial undertaking at twenty five percent of such business profits of Rs.31.29 lakhs/Rs.6.03 lakhs respectively. Audit scrutiny (August 1990) revealed that the profits and gains of the assessee company included Rs.17.96 lakhs/Rs.18.41 lakhs being interest income and income from sale of scrap for the assessment years 1985-86 and 1986-87 respectively. As these items of receipts cannot be held as income derived from the business activity of the assessee company as per the judicial decisions, the actual profits derived from the business after excluding this receipt would be Rs.13.33 lakhs/nil and consequently the relief admissible towards profits and gains from industrial undertaking would be Rs.3.33 lakhs/nil for the assessment years 1985-86 and 1986-87 respectively. The mistake resulted in incorrect grant of excess relief of Rs.4.47 lakhs/Rs.1.51 lakhs for these two years involving an aggregate short levy of tax of Rs.6.05 lakhs (including interest for belated filing of return and short payment of advance tax).

3. The Act also provides that the losses, unabsorbed depreciation and investment allowance of earlier years in respect of new industrial undertaking will be taken into account in determining the profits of the new unit for the relevant year even though they may have been set off against the profits of the tax payer from other source.

(i) In the assessment of a private limited company for the assessment years 1985-86 and 1986-87 completed in March 1987 and January 19889 and finally revised in June 1989 and November 1989 respectively, deduction on account of profits and gains of two new hotel units constructed after 1 April 1981 was allowed at Rs.4.15 lakhs and Rs.20.52 lakhs respectively. The new units had past losses aggregating to Rs.53.34 lakhs by way of unabsorbed depreciation pertaining to assessment years 1982-83 to 1984-85 which were not carried forward but set off against profits of old units. However, for the purpose of determining relief in respect of profits of new units in assessment years

1985-86 and 1986-87, the unabsorbed depreciation of earlier years was required to be set off first against the profits of the new units alone. As the relief of Rs.4.14 lakhs and Rs.20.52 lakhs was computed on the unadjusted profits of Rs.16.58 lakhs and Rs.82.08 lakhs there was excess grant of relief of Rs.4.14 lakhs and Rs.9.19 lakhs in assessment years 1985-86 and 1986-87 respectively. The mistake resulted in underassessment of income equivalent to the excess relief which led to short levy of tax of Rs.10.50 lakhs (including interest of Rs.10,609 for belated submission of return and Rs.2.25 lakhs for short payment of advance tax) in assessment years 1985-86 and 1986-87.

Ministry of Finance have accepted the audit observation.

(ii) In the assessment of a closely held company for the assessment year 1985-86, completed in October 1988, the taxable income derived from a new industrial undertaking for the purpose of computing the tax holiday profits was determined at Rs.1.64 crores. Audit scrutiny in June 1989 revealed that a loss of Rs.60.39 lakhs incurred by the said industrial undertaking in the assessment year 1984-85 was not taken into account while determining the tax holiday profits. The above omission resulted in an underassessment of income of Rs.15.10 lakhs for assessment year 1985-86 involving a short levy of tax of Rs.9.51 lakhs.

Ministry of Finance have accepted the audit observation.

(iii) While completing the assessment of a limited company for the assessment year 1985-86 in June 1988, the assessing officer allowed a deduction of Rs.9.49 lakhs which included unabsorbed relief of Rs.8.32 lakhs for the assessment year 1982-83 and Rs.1.17 lakhs for the assessment year 1983-84 on account of profits and gains from industrial undertakings. It was, however, seen in audit that there was no such unabsorbed relief for the assessment year 1982-83. The excess

allowance of deduction resulted in underassessment of income by Rs.8.32 lakhs involving short levy of tax of Rs.7.73 lakhs (including interest of Rs.2.49 lakhs leviable under Section 215 of the Act).

Incorrect allowance of deduction in respect of profits derived from newly established industrial undertaking and the ship (prior to 31 March 1981)

3.40.1 Under the provisions of the Income-tax Act, 1961, prior to its amendment by Finance Act 1980, with effect from the assessment year 1981-82, where the gross total income of an assessee, being an Indian company included any profits and gains derived from a new industrial undertaking which went into production before 1 April 1981, or a ship which was brought into use by the Indian company at any time within a period of thirty-three years next following the Ist day of April 1948 (**i.e.** before 1 April 1981), the assessee became entitled to tax relief in respect of such profits and gains upto 6 percent per annum (7.5 percent from 1 April 1976) of the capital employed in the industrial undertaking or ship in respect of the assessment year relevant to the previous year in which the undertaking began to manufacture or produce articles or the ship was first brought to use and each of the four succeeding assessment years. Where, however, such profits and gains fell short of the relevant amount of the capital employed during the previous year, the amount of such short fall or deficiency was to be carried forward and set off against future profits upto seventh assessment year reckoned from the end of the initial assessment year.

(i) In the assessment of an Indian company for the assessment year 1987-88, completed in March 1990, the assessee claimed relief to the extent of Rs.57.72 lakhs in respect of profits derived from two ships and the same was allowed in the assessment. As the assessment was completed at a loss of Rs.6.52 crores the relief determined as admissible was allowed to be carried forward for future set-off. Audit scrutiny in May 1990, however, revealed that both the ships were acquired and brought ito use much after 1 April 1981, and as such no relief in respect of profits derived from these two ships was admissible. The incorrect grant of relief, therefore,

resulted in excess carry forward of deficiency of Rs.57.72 lakhs for the assessment year 1987-88 involving a potential tax effect of Rs.34.63 lakhs.

The department has accepted the audit observation.

(ii) In the assessment of a limited company, for the assessment year 1985-86, completed by the Deputy Commissioner of Income-tax in March 1988 (subsequently revised in February 1989) deduction of Rs.15.81 lakhs as `tax holiday relief' attributable to the newly established industrial unit was allowed. It was seen in audit (December 1988/January 1989) that the new industrial unit had commenced production during the previous year ended on 30 April 1984 **i.e.** after March 1981. As the aforesaid deduction was applicable only in respect of undertakings commencing production prior to 31 March 1981, the company was not entitled to the deduction. The mistake resulted in excess computation of loss by Rs.15.81 lakhs involving notional tax effect of Rs.9.13 lakhs.

Ministry of Finance have accepted the audit observation.

2. In the assessment of a Government construction company for the assessment year 1983-84 completed in March 1986 and revised in September 1986, the assessing officer erroneously allowed relief of Rs.28.87 lakhs including unabsorbed relief of Rs.10 lakhs. As the assessee company was not engaged in any manufacturing activity, the relief allowed by the assessing officer was irregular. The mistake resulted in underassessment of income of Rs.28.87 lakhs involving short levy of tax of Rs.23.68 lakhs (including interest of Rs.0.81 lakh and Rs.6.59 lakhs under Section 139(8) and 215 of the Act resepctively).

The department has accepted the audit observation.

3. The method of computing capital employed in the industrial undertaking was laid down

in the Income-tax Rules, 1962, according to which the capital employed would be the value of assets as on the first day of the computation period of the undertaking as reduced by moneys and debts owed by the assessee on that day. The capital employed was, therefore, to be calculated on the basis of owned capital and reserves only, exclusive of borrowed capital. Under an amendment brought about by the Finance Act, 1980, to the Act, the provision of the Rules were incorporated in the Act itself retrospectively from 1 April 1972.

(i) In the computation of capital employed by a public limited company in one of its new industrial units for the assessment years `1973-74, 1974-75 and 1975-76 to allow tax relief at 6 percent thereon, the department made no deduction from the value of assets on account of borrowed money of Rs.61.12 lakhs, Rs.101.78 lakhs and Rs.62.31 lakhs for calculation of capital employed on the basis of the orders of the Commissioner of Income-tax (Appeal). The department went in appeal against the orders of the Commissioner of Income-tax (Appeal) to the Income-tax Appellate Tribunal which directed the department to await the final decision of the Supreme Court as the judicial pronouncement regarding computation of capital was still pending before that Court. The Supreme Court upheld, in January 1985, the validity of deduction of borrowed money in the computation of capital employed under the relevant provisions of the Income-tax Act, 1961 retrospectively with effect from 1 April 1972. As capital employed would be the value of assets as on the first day of the computation period as reduced by the money borrowed and debts owned on that day, the treatment of borrowed money as capital led to excess computation of capital employed by Rs.225.21 lakhs and consequent excess relief of Rs.13.51 lakhs (Rs.3.67 lakhs, Rs.6.10 lakhs and Rs.3.74 lakhs in the respective computations) resulting in identical underassessment of income in the three assessment years and aggregate short levy of tax of Rs.9.73 lakhs (including short levy of surtax of Rs.1.87 lakhs and interest of

Rs.0.06 lakh for belated submission of return). No rectification (to the assessments and revisions thereto made between September 1976 and March 1985) was, however, made.

(ii) In the assessment of a private limited company for the assessment years 1981-82 and 1982-83 (assessments completed in March 1983 and March 1985), while computing the net profits, the assessing officer did not take into account proportionate interest amounting to Rs.2.31 lakhs and Rs.3.22 lakhs attributable to new unit leading to excessive computation of capital employed and relief of Rs.2.66 lakhs and Rs.2.74 lakhs involving short levy of tax aggregating to Rs.3.40 lakhs for the assessment years 1981-82 and 1982-83.

Ministry of Finance have accepted the audit observation.

4. Where, however, such profits and gains fell short of the relevant percentage amount of the capital employed during the previous year, the amount of such short fall of deficiency was to be carried and set off against future profits upto the seventh assessment year reckoned from the end of the initial assessment year.

(i) In their observations in March 1982, in respect of the assessment years 1974-75 and 1975-76, besides pointing out excess deductions towards bonus and under Chapter VIA for the assessment year 1975-76, internal audit had pointed out that set off of deficiency of machine shop unit to the extent of Rs.22.36 lakhs and Rs.36.57 lakhs against the income for the assessment years 1974-75 and 1975-76 was irregular, since this unit commenced commercial production during the previous year relevant to the assessment year 1966-67 and such set off was admissible only against income upto the assessment year 1973-74.

Based on a reference, the assessee replied in April 1983 that the commercial production of this unit started only during the previous year relevant to the assessment year 1967-68

and hence it was entitled for set-off upto the assessment year 1974-75. Even though the assessment for the assessment year 1975-76 was revised in August 1983 withdrawing the excess deduction towards bonus and gains in October 1984 withdrawing the irregular deductions under Chapter VIA, the deficiency of Rs.36.57 lakhs set-off earlier was not withdrawn. When the omission was pointed out by the Revenue Audit in September 1986 rectificatory action was taken in March 1987, after rejecting the assessee's contention that such rectification got time barred by March 1985 as the set-off was allowed in the revision made in March 1981. Based on appeal by the assessee, Commissioner of Income-tax (Appeals) in his orders issued in February 1988 upheld the contention of the assessee and set aside the revision made in March 1987 as time-barred.

Meanwhile the assessment for the earlier assessment year 1974-75 was revised in March 1988 and in this, out of income of Rs.22.44 lakhs before set off of deficiency, Rs.8.96 lakhs alone was determined as income derived from this unit and after setting off the deficiency to the extent of Rs.8.96 lakhs, the balance was treated as lapsed since set off was permissible only upto the assessment year 1974-75, the seventh year reckoned from the end of the initial assessment year 1967-68. In the consequential revision made in March 1988 for the assessment year 1975-76, no set off was allowed in respect of deficiency of the machine shop unit.

However, when the orders were issed by the Commissioner of Income-tax (Appeals) in February 1988 setting aside the revision made in March 1987, the assessment for the assessment year 1975-76 was revised in August 1988 allowing set off of deficiency to the extent of Rs.36.57 lakhs, without noticing that the assessment for the earlier assessment year 1974-75 was revised in March 1988 indicating that the deficiency cannot be carried forward from the assessment year 1974-75 and in the consequential revision made in March 1988 for the assessment year 1975-76 no set off was allowed. This mistake

resulted in under-assessment of income for the assessment year 1975-76 involving a short demand of tax of Rs.18.23 lakhs.

(ii) In the assessment of a company for the assessment year 1980-81 (completed in September 1983), tax holiday relief in respect of its new industrial undertaking was computed at Rs.58.51 lakhs and after allowing relief to the extent of the available profit of Rs.14.54 lakhs for that year, the balance deficiency of Rs.43.97 lakhs was allowed to be carried forward. This deficiency was set off in the assessment for the assessment year 1981-82 completed in February 1985. Subsequently, the relief for the assessment year 1980-81, was recomputed at Rs.56.83 lakhs in a revisional order of March 1987 and after allowing relief to the extent of the available profit of Rs.14.54 lakhs for that year, the balance deficiency of Rs.42.29 lakhs was allowed to be carried forward. As the original carry forward of deficiency of Rs.43.96 lakhs was already set off in the assessment for the assessment year 1981-82 made in February 1985 the excess carry forward of Rs.1.67 lakhs (Rs.43.96 lakhs minus Rs.42.29 lakhs), set off in the assessment for the assessment year 1981-82, should have been withdrawn. The mistake resulted in excess set off relief of Rs.1.67 lakhs with consequent underassessment of income of an identical amount.

Similarly, in the assessment for the assessment year 1981-82 made in July 1984, tax holiday relief in respect of another new unit (Unit No.2) of the assessee was computed at Rs.54.48 lakhs and after allowing relief to the extent of the available profit of Rs.47.14 lakhs the balance deficiency of Rs.7.34 lakhs was allowed to be carried forward. This deficiency was fully set off in the assessment for the assessment year 1982-83 made on 7 February 1985 and revised in March 1987 and May 1988. Subsequently, the profit of the said unit for the assessment year 1981-82 was recomputed at Rs.1.02 crores (in February 1985) and the entire tax holiday relief of Rs.54.48 lakhs was allowed in the said assessment, leaving thereby nc

unabsorbed deficiency for carry forward. As, however, the deficiency of Rs.7.34 lakhs originally computed was already set off in the assessment for the assessment year 1982-83 (made on 7 February 1985) it should have been withdrawn, consequent on revision of assessment for the assessment year 1981-82 made in February 1985 allowing the entire relief of Rs.54.48 lakhs. Omission to do so (September 1988) resulted in excess set off of deficiency of Rs.7.34 lakhs with consequent underassessment of income of identical amount for the assessment year 1982-83.

As a result of the above mistakes, there was aggregate underassessment of income of Rs.9 lakhs with consequent undercharge of tax of Rs.5.12 lakhs for the assessment years 1981-82 and 1982-83.

The department has accepted the audit observation.

Incorrect deduction in respect of royalty, etc, from a foreign enterprise

3.41 Under the provisions of Income-tax Act, 1961, where the gross total income of an Indian company included any income by way of royalty fees or any similar payment received from a foreign enterprise in consideration for technical services rendered outside India, a deduction of the whole of such income shall be allowed in computing the income of the company subject to the fulfilment of certain prescribed conditions. Under an amendment to the Act by the Finance (No.2) Act, 1980, effective from 1 April 1982, the relief is to be determined with reference to the net income and not on the gross income.

While completing assessment of a Government company for the assessment year 1983-84 in February 1986, the assessing officer allowed relief of Rs.461.50 lakhs restricting it to Rs.459.90 lakhs, thereby reducing the gross total income to nil. This was calculated without deducting from the income the proportionate headquarters and other common expenses incurred in India (including weighted deduction from export markets development allowance). As the company was

executing projects both in India and abroad, the headquarters and other common expenditure incurred in India was required tc be allocated proportionately and the profit and gains from business from business firm foreign contracts reduced correspondingly. The admissible deduction under this section worked out to Rs.376.65 lakhs instead of Rs.459.90 lakhs. The excess deduction of Rs.83.25 lakhs resulted in under assessment of income of Rs.83.25 lakhs resulted in short levy of tax of Rs.49.75 lakhs including interest, leviable under sections 139(8) and 215 of the Act respectively.

The department has accepted the audit observation.

Incorrect allowance of double taxation relief

3.42.1 Under the Double Taxation Avoidance agreements between India and Greece and India and Japan, where a resident enterprise of Greece/Japan derives profit through shipping operation in India, the tax leviable on such profit in India shall be reduced by an amount equal to 50 percent thereof provided the income so charged to tax in India is also charged to tax in Greece/Japan. The agreements further provide that the amount of tax paid on Indian income shall be allowed credit against tax payable in Greece/Japan. Further, it has been judicially held* that in order to get the benefit of double taxation, income assessed to tax in one country is required to be assessed in the other country as well

In the case of three non-resident shipping companies deduction of Rs.1.49 crores for the assessment years 1981-82 to 1984-85, 1983-84 and 1987-88, being 50 percent of the income-tax levied in India on Indian income, were allowed by the Inspecting Assistant Commissioners in the assessmemts made between November 1983 and February 1986, February 1986 and March 1988 respectively. The assessees(resident of Greece and Japan) had suffered world losses in the respective assessment years and did not pay any tax in

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*** 58 ITR 468 - CIT Vs New Citizen Bank and 61 ITR 632 - CIT Madras Vs Indian Bank Ltd.**

Greece/Japan in the relevant assessment years. There was, therefore, no double taxation of the income earned in India in Greece/Japan and as such the provisions of the above agreements were not applicable in these cases. Allowance of 50 percent deduction from Indian Income-tax as per double taxation avoidance agreement was accordingly irregular. The mistakes led to undercharge of tax of Rs.1.51 crores (including interest of Rs.2.37 lakhs).

The department has accepted the audit observations.

2. In the case of two non-resident shipping companies, a deduction of Rs.1.04 crores being 50 percent of the income tax levied in India on Indian income was allowed in the assessment for the assessment years 1984-85 and 1987-88 and 1985-86 to 1987-88 assessed in November 1984 and March 1988 and between December 1985 and March 1988 respectively. The companies, residents of Japan, incurred world losses in the respective assessment years and as such were not taxed in Japan. Since there was no double taxation of the same income the agreement for avoidance of double taxation was inapplicable in this case. Thus, granting of 50 percent deduction from Indian income tax as per double taxation avoidance agreement was irregular. The mistake led to aggregate undercharge of tax of Rs.1.17 crores (including interest of Rs.12.57 lakhs for short payment of advance tax).

The department has accepted the audit observations.

Non-levy of minimum tax due to omission to restrict certain deductions in the case of companies.

3.43.1. Under the Income-tax Act, 1961, as applicable to the assessment years 1984-85 to 1987-88, where in the case of a company the aggregate amount of deduction admissible under certain specified provision of the income-tax Act, exceeds seventy percent of the total income as computed before making any such deduction that is, the pre-incentive income, the amount to be deducted under these provisions will be restricted to seventy percent of pre-incentive total income.

Deductions on account of donations, relief in respect of export turnover, capital expenditure on scienitific research, unabsorbed depreciation brought forward from earlier years, intercorporate dividends etc. are some of the items specified for the purpose of applying the aforesaid restrictions.

In the assessment for the assessment year 1986-87 of a widely held company completed in January 1990 at Rs.0.78 lakhs, the assessing officer allowed total deduction of Rs.249.23 lakhs from Rs.250.01 lakhs (income before deduction) without applying the aforesaid restrictive provision of seventy per cent. The deduction allowed, comprised apart from past years business losses at Rs.142.96 lakhs and unabsorbed depreciation of Rs.64.58 lakhs, current investment allowance of Rs.7.76 lakhs, donation of Rs.0.31 lakhs, intercorporate dividend of Rs.0.70 lakhs and unabsorbed investment allowance of Rs.32.92 lakhs. In the computation, the non-specific items of deduction (outside the seventy percent limit) i.e. past year's losses and unabsorbed depreciation of Rs.142.96 lakhs and Rs.64.58 lakhs are to be allowed from the income of Rs.250.01 lakhs(income before deduction) in order to arrive at the pre-incentive total income of Rs.42.47 lakhs. Seventy percent of Rs.42.47 lakhs is allowable as maximum deduction against specified items leaving aside thirty percent of Rs.42.47 lakhs as minimum income to be taxed. The assessee was thus entitled to a deduction of Rs.29.73 lakhs (70 percent of Rs.42.47 lakhs) representing part of unabsorbed investment allowance (out of Rs.32.92 lakhs),leaving a taxable income of Rs.12.74 lakhs. As the department computed taxable incomne at Rs.0.78 lakhs there was under assessment of Rs.11.96 lakhs. The mistake resulted under charge of tax of Rs.9.06 lakhs (including non-levy of interest of Rs.2.72 lakhs for short payment of advance tax and Rs.0.06 lakhs for belated submission of return). However, the assessee would be entitled to carry forward of unabsorbed investment allowance to the extent of Rs.3.19

lakhs and current investment allowance of Rs.7.76 lakhs only.

2. In the assessment of a company for the assessment year 1986-87 (completed in March 1987) the assessing officer allowed deduction under the specified provisions of the Act to the extent of Rs.662.72 lakhs being seventy percent of the pre-incentive total income of Rs.946.75 lakhs. It was seen in audit that the actual deduction under the specified provisions of the Act allowable was Rs.651.07 lakhs only. As the deduction allowable was not more than seventy percent of the pre-incentive total income, the same was required to be restricted to actual allowable deduction i.e. to Rs.651.07 lakhs instead of Rs.662.72 lakhs as allowed by the department. The mistake resulted in under assessment of income of Rs.11.65 lakhs involving short levy of tax of Rs.8.79 lakhs (including interest payable for short payment of advance tax).

3. The assessment of a widely held company for the assessment year 1987-88 was completed in March 1990 on a loss of Rs.40.73 lakhs after allowing full deduction of investment allowance for the current year amounting to Rs.71.18 lakhs without computing the pre-incentive income and restricting investment allowance to seventy percent of that Income. The pre-incentive income worked out to Rs.30.45 lakhs and the investment allowance deductible would therefore be Rs.21.32 lakhs (seventy percent of Rs.30.45 lakhs) the balance being carried forward to next year for absorption. Thus the income of Rs.9.13 lakhs (being 30 percent of Rs.30.45 lakhs) escaped assessment. The mistake resulted in under assessment of income of Rs.9.13 lakhs involving under charge of tax of Rs.6.57 lakhs(including interest of Rs.2 lakhs for short payment of advance-tax).

Ministry of Finance have accepted the audit observation.

4. The assessment of a widely held company for the assessmewnt year 1986-87 was completed by the Deputy Commissioner of Income-tax in December 1988 assessing the

taxable income at Rs.14.13 lakhs which was thirty percent of the pre-incentive income of Rs.47.11 lakhs determined for the purpose of restricting the deductions allowable under the Act to levy minimum tax. Audit scrutiny in February 1990 revealed that the company was allowed a deduction of Rs.31.97 lakhs towards capital expenditure on scientific research and the pre-incentive income was determined without applying the restriction on the above deduction as specified in the Act. The mistake resulted in incorrect determination of pre-incentive income as Rs.47.11 lakhs instead of Rs.79.09 lakhs resulting in underassessment of income by Rs.9.59 lakhs and short levy of tax of Rs.6.71 lakhs (including Rs.1.92 lakhs being interest to be withdrawn granted on the excess payment of advance tax).

The department has accepted the audit observation.

5. In the assessment for the assessment year 1986-87 completed in March 1990, total income of Rs.4.23 lakhs was computed after adjusting unabsorbed deductions on export business profit relating to the assessment years 1984-85 (Rs.1.26 lakhs) and 1985-86(Rs.14.20 lakhs) arising from the restrictive provisions of chapter VI-A of the Act. It was, however, noticed that due to rectification of the assessment for the assessment year 1985-86 in May 1990, the unabsorbed deduction on export business profit for that assessment year was reduced to Rs.7.77 lakhs from Rs.14.20 lakhs. The assessing officer, however, did not revise the assessment for the assessment year 1986-87 in the wake of rectification carried out for earlier assessment year 1985-86. This led to excess adjustment of unabsorbed deduction on export business profit to the extent of Rs.6.43 lakhs with consequent underassessment of total income by a like amount and tax undercharge of Rs.5.90 lakhs (including interest of Rs.2.18 lakhs for short payment of advance tax).

Ministry of Finance have accepted the audit observation.

Mistake in the levy of minimum tax on book profits of companies

3.44.1. Under the Income-tax Act, 1961, with effect from the assessment year 1988-89, the chargeable taxable income of any company whose total income as computed under the other provisions of the Act in respect of any previous year is less than 30 percent of its book profit, shall be deemed to be the amount equal to 30 percent of such book profits. For this purpose, book profit means the net profit as shown in the profit and loss account for the relevant previous year prepared in accordance with the provisions of the Companies Act, 1956 subject to certain additions/delections. Brought forward losses or unabsorbed depreciation whichever is less would be reduced in arriving at the book profits. This has also been clarified by the Central Board of Direct Taxes in their circular No.495 of July 1987.

(i) The assessment of a widely held company for the assessment year 1988-89 was completed in January 1989 by the Deputy Commissioner of Income-tax (Special Range) determining the taxable income at Rs.48,880 being 30 percent of its book profits of Rs.1.63 lakhs. This was arrived at after deducting from the net profit of Rs.37.60 lakhs as per the profit and loss account, a sum of Rs.35.97 lakhs being the carried forward unabsorbed depreciation relating to assessment years 1985-86 to 1987-88. Audit scrutiny (February 1990), howevcer, revealed that carried forward unabsorbed business loss for assessment year 1985-86 amounted to Rs.6.86 lakhs while the carried forward unabsorbed depreciation for the assessement years 1985-86 to 1987-88 aggregated to Rs.35.97 lakhs. According to the provisions of the Act, the book profit should have been computed by deducting from the profits as per profit and loss account the carried forward unabsorbed business loss only which was less than the unabsorbed depreciation carried forward. If the deduction from the net profit of Rs.37.60 lakhs had been so restricted to Rs.6.86 lakhs, the taxable income being 30 percent of the balance would work out to Rs.9.22 lakhs. Omission to do so resulted in under assessment of income by Rs.8.73 lakhs

involving a short levy of tax of Rs.4.60 lakhs (exclusing interest of Rs.50,951).

The department has accepted the audit observation.

(ii) The assessment of a public sector oil corporation for the assessment yar 1988-89 was completed by the Deputy Commissioner(Special Range) in November 1989 on a taxable income of Rs.151.16 crores under the restrictive provisions of the Act. It was seen in audit that while computing the book profits, the assessing officer added back to the net profit the depreciation debited to the account as per the company Law and deducted the depreciation allowable under the Income-tax Rules there from. As this adjustment is not provided in the Act, it was not in order. The mistake resulted in reducing the `Book profits' by Rs.10.82 crores with underassessment of income by an indentical amount involving short levy of tax by Rs.5.83 crores (including interest leviable for late filing of the return).

The department has accepted the audit observation.

2. Where the gross total income of an assessee, being a domestic company, includes any income by way of dividends from a domestic company, there shall be allowed, in computing its total income, a deduction of 60 percent of such dividends. Any income including dividend derived by a domestic company from a partnership firm as a result of the company's investment in such firm does not qualify for such deduction.

A private limited company was assessed for the assessment year 1989-90 in March 1990 at the declared income of Rs.11.61 lakhs being 30 percent of book profits of Rs.38.69 lakhs according to special provisions relating to companies for chargeability of minimum profits, without carrying out any adjustment. The taxable income was shown nil after claiming set off of unabsorbed loss of earlier year at Rs.8.68 lakhs and the balance of Rs.27.94 lakhs towards exemption on

account of inter corporate dividends out of net profit of Rs.36.62 claimed in the profit and loss account.

Audit scrutiny however, disclosed that the entire receipts of Rs.39.73 lakhs credited in the profit and loss account was received as allocated share from a partnership firm in which the assessee company was a partner. Only a paltry sum of Rs.8,000 was credited as `dividend' from another company which alone qualified for the aforesaid intercorporate dividends exemptions and worked out to Rs.5,000 only. The assessee not being entitled to deduction stipulated as `intercorporate dividends the provisions relating to companies for chargeability of minimum profits was not applicable to it as the income under the normal provisions itself works out to Rs.27.89 lakhs and thus the company ought to have been assessed at Rs.27.89 lakhs, after allowing deduction of Rs.5,000 against the dividend income of Rs.8,000 towards `inter corporate dividends' exemption, instead of income at Rs.11.61 lakhs, as assessed. The balance amount was required to be disallowed through adjustment. The omission to make any adjustment resulted in under assessment of income by Rs.16.28 lakhs and consequential under charge of tax of Rs.9.40 lakhs. The above adjustment would also attract additional tax of Rs.1.88 lakhs and thus the aggregate under levy works out to Rs.11.28 lakhs in assessment year 1989-90.

Irregular grant of refund

3.45 Under the Income-tax Act, 1961, where an order giving rise to refund is the subject matter of appeal or further proceedings or where any other proceeding under the Act is pending and the assessing officer is of the opinion that the grant of refund is likely to adversely affect the revenue, the assessing officer may withhold the refund.

In the assessment of a company (State owned corporation) for the assessment year 1986-87 made in March 1989, profits paid by the assessee company to the State Government in the shape of lease rent and debited to the profit and loss account was disallowed to the extent of Rs.1541.07 lakhs being excess over

reasonable sum of lease rent due, as per certain formula and commission of Rs.43.22 lakhs paid by the State Government to the company in lieu of the profits was deducted resulting in a net addition of Rs.1497.75 lakhs. The addition made by the Assessing Officer was not upheld in appeal by the Commissioner of Income-tax (Appeals). The department filed an appeal with the Appellate Tribunal which was pending. While giving effect to the appellate orders in September 1989, the assessing officer deducted the sum of Rs.1541.07 lakhs regarding lease rent alongwith other deductions allowed in appeal, but the commission of Rs.43.22 lakhs deducted in original assessment order was not added back. Only a note of making such addition was appended to the assessment order. The taxable income assessed in the revisionary order was Rs.23.82 lakhs as against the returned income of Rs.109.65 lakhs. Further, a sum of Rs.56.20 lakhs on account of provision for income-tax debited to the profit and loss account was omitted to be added back in the original assessment. The omission was pointed out by audit in October 1989 which was subsequently accepted by the department. Consequent upon the revisionary order passed in September 1989, a refund of Rs.40.89 lakhs on account of excess payment of taxes was allowed to the assessee in December 1989, which was not due because the addition of Rs.99.42 lakhs (Rs.43.22 lakhs plus Rs.56.20 lakhs) to be made, was within the knowledge of the department as on the date of refund in December 1989 and another addition of Rs.1497.75 lakhs was contested in appeal before the Tribunal. The refund of Rs.40.89 lakhs to the assessee was accordingly not in order and resulted in irregular refund of Rs.40.89 lakhs.

Ministry of Finance have accepted the audit observation.

Non-levy or incorrect levy of interest

Interest for delay in filing the return

3.46.1. Under the Income-tax Act, 1961, where the return for an assessment year is furnished after the specified date, the assessee shall be liable to pay simple

interest at twelve percent (fifteen percent from October 1984) per annum from the date immediately following the specified date to the date of furnishing the return on the amount of tax determined on regular assessment as reduced by the advance tax, if any, paid and any tax deducted at source. Further the Income-tax Rules, 1962, provide that the period for which interest is to be calculated shall be rounded off to a whole month and for this purpose any fraction of a month shall be ignored. The Central Board of Direct Taxes on the advice by the Ministry of Law clarified in December 1974 that for the purpose of calculating interest the actual date of filing the return should be included in computing the period for which interest is leviable.

(i) A government company filed the return of its income for the assessment year 1985-86 on 30 September 1985 as against the due date of 31 July 1985. The assessee company was, therefore, liable to pay interest for two months. In the assessment made in November 1987 and revised in September 1988, the assessing officer, however, levied interest for one month only. This resulted in short levy of interest of Rs.31.27 lakhs.

(ii) In the case of a company the return of income for the assessment year 1986-87 was filed on 3 June 1987 declaring income of Rs.34,900. The due date for filing the return was 30 June 1986. The assessment was completed on 31 March 1989 on a total income of Rs.78.98 lakhs on which tax of Rs.49.76 lakhs was levied. It was seen in audit that the assessee company had not sought any extension of time for submission of return beyond the specified date. As the return was filed beyond the specified date the assessee company was liable to pay interest of Rs.6.82 lakhs which was not levied.

Interest for short payment of advance tax

3.47 Under the Income-tax Act, 1961, where an assessee company has paid advance tax for any financial year on the basis of its own estimate and the advance tax paid falls short of eighty three and one third percent of the tax determined on regular assessment,

interest at twelve percent (fifteen percent from 1 October 1984) per annum is payable by the assessee on the amount by which the advance tax paid falls short of the assessed tax from the first day of the next financial year to the date of regular assessment. Where, however, as a result of an order of rectification or revision, the amount on which interest as aforesaid was payable has been increased or reduced as the case may be, the interest shall be increased or reduced accordingly.

The regular assessment of a widely held company for the assessment year 1983-84 was originally completed in March 1986 on a total income of Rs.8.70 crores. As the advance tax paid fell short of the statutory percentage of the tax determined on regular assessment, interest of Rs.35.23 lakhs for short payment of advance tax was also levied. Due to certain mistakes apparent from records, the assessment was subsequently revised and the total income was also reduced. As there was no short fall in the advance tax reckoned on the basis of the reduced income, no interest was leviable for short payment of advance tax in the said revised assessment. The assessment was, however, further revised in pursuance of an order of the Commissioner of Income-tax in March 1989, whereby the total income was increased to Rs.9.17 crores and on the basis of the increased total income, interest of Rs.41.02 lakhs for the short payment of advance tax was leviable. It was, however, noticed in audit in October 1989 that no such interest was levied while revising the assessment in March 1989. The omission resulted in non-levy of interest of Rs.41.02 lakhs for the assessment year 1983-84.

Ministry of Finance have accepted the audit observation.

Interest for delay in payment of tax demand

3.48 Under the Income-tax Act 1961, any demand for tax should be paid by an assessee within thirty five days of service of notice of the relevant demand and failure to do so would attract simple interest at 12 percent (15 percent from 1 October 1984) per annum

from the date of default and 1.5 percent per month or part thereof from 1 April 1989. In November 1974, the Central Board of Direct Taxes issued instructions that interest for belated payment of tax should be calculated and charged within a week of the date of final payment of the tax demand. The Income-tax Rules, 1962, lay down that where the demand has not been collected in full, interest has to be calculated and charged on the amount of demand pending at the end of each financial year.

The assessments of three assessee companies for the assessment years between 1982-83 and 1986-87 were completed between April 1987 and March 1988 in two Commissioners charges and notices of tax demand were served on the assessees between April 1987 and December 1988. Subsequently, on revision of original tax demand to give effect to appellate orders, the revised tax demands were paid after expiry of the permissible period of thirty five days from the date of service of demand notice and as such the assessees were liable to pay interest under the provision of the Income-tax Act. The omission to levy interest led to non-levy of interest aggregating to Rs.104.07 lakhs.

Sr. No.	Commissioners' charge Name of the assessee	Assessment year	Date of issue of tax demand	Final tax demand	Non levy/ short-levy of interest
				(in lakhs of rupees)	
1.	West Bengal I A	1985-86	December 1988	311.32	63.82
2.	West Bengal I B	1985-86	March 1988	75.08	29.66
3.	Tamil Nadu II A	1982-83 1983-84	April 1987	14.06 23.70	10.59

Ministry of Finance have accepted the audit observation in one case.

Interest for failure to deduct and deposit tax deducted at source

3.49 If a person responsible for deductin tax at source under the Income-tax Act doe not deduct such tax or after deducting fail to pay tax as required by the Act, he i liable to pay interest at the rate of 1 percent (15 percent from 1 October 1984) pe annum on the amount of such tax from the dat on which such tax was deductible or deducte to the date on which such tax is actuall paid.

In the assessment of a assessee company for the assessment year 1979-80 to 1981-82, assessed in March 1990 in Patna Commissioners' charge, either the tax was not deducted at source or if deducted, was not deposited with the Central Government within the specified period. The department did not levy any interest for non/short deduction of tax at source. The failure to do so resulted in non-levy of interest aggregating to Rs.9.76 lakhs.

Sr. No.	Commissioner's charge Name of assessee(s) Assessment years	Nature of objection	Non-levy of interest/ short deduction of tax
1.	Patna A 1979-80, 1980-81 and 1981-82	Failure to deposit tax accumulated from Rs.90,261 as on 30 June 1978 to Rs.6.82 lakhs as on 30 June 1981 which was deducted at source to the credit of Central Government.	Rs.9.76 lakhs

Ministry of Finance have accepted the audit observation.

Incorrect working in interest

3.50 In the assessment of two companies for the assessment years 1986-87 and 1987-88 assessed in March 1989 and March 1990 in two Commissioners' charges, interest of Rs.67.72 lakhs and Rs.3.24 lakhs for 35 and 23 months respectively for non-payment or failure to file estimate of advance tax were levied on the assessed tax. It was, however, noticed

that while computing the interest, the assessing officer had wrongly calculated the interest for 35 months instead of the correct amount of Rs.69.65 lakhs for 36 months and of Rs.3.24 lakhs (23 months for the period from 1 April 1987 to 28 February 1990 (35 months) instead of the correct amount of Rs.4.93 lakhs for the same period respectively. This led to short levy of interest aggregating to Rs.3.62 lakhs

Ministry of Finance have accepted the audit observation in one case

Avoidable payment of interest by Government

3.51 The Income-tax Act, 1961 provides that interest would be payable in respect of refunds arising as a result of orders passed in appeal if the refund order is not issued within a month from the date of the appellate order. The Central Board of Direct Taxes had clarified in January 1977 that it was of paramount importance to ensure that all appellate, revisionary or other orders were received in time and given effect to with extra-ordinary promptness ensuring that in any case they were given effect to within a month of the date of order.

1. In the case of a Government corporation, the assessment for assessment year 1985-86 was revised by the assessing officer in July 1988 and in pursuance of Commissioner (Appeals) order of February 1988, the assessee was allowed refund of Rs.2.62 crores and interest of Rs.45.87 lakhs. The amount of interest allowed to the assessee included Rs.12.50 lakhs which had to be paid as the refund was not issued within one month of the date of appellate order. The failure to follow the Board's instructions by the assessing officer resulted in avoidable payment of interest of Rs.12.50 lakhs on the amount of Rs.2.50 crores deposited by the assessee in pursuance of the assessment order. It was further observed in audit that the amount of interest of Rs.45.87 lakhs also included Rs.2.12 lakhs allowed to the assessee on an amount of Rs.12.10 lakhs deposited by the assessee before the regular assessment was made. This was not admissible under Section 244(1A) of the Act.

The department has accepted the audit observation.

2. The appellate orders in respect of a private limited company for the assessment years 1975-76 and 1976-77 were issued in May 1980 and March 1983 respectively. Under the instructions of the Board the effect to the appellate orders was required to be given by June 1980 and April 1983. The department, however, made refund orders in December 1987 and May 1988 and finally paid interest of Rs.1.96 lakhs and Rs.1.09 lakhs in February 1989 for the assessment years 1975-76 and 1976-77 respectively. Had the department granted refunds on due dates, excess payment of interest of Rs.2.39 lakhs in aggregate for two years could have been avoided.

The department has accepted the audit observation.

Omission to levy penalty

3.52.1. Under the provisions of the Income-tax Act, 1961, no person shall after 30 June 1984, take or accept from any other person any loan or deposit of Rs.10,000 (Rs.20,000 from 1 April 1989) or more otherwise than by an account payee cheque or an account payee bank draft subject to certain exceptions. Similarly, no person shall repay to any person any deposit otherwise than by an account payee cheque or account payee bank draft, where the amount of such deposit or deposits with interest is Rs.10,000 or more.

Any person contravening these provisions without reasonable cause can be proceeded against at the instance of the Commissioner and he is, inter alia, liable to pay fine equal to the amount of such loan or deposit. In cases of contravention of the provision from 1 April 1989, a penalty equal to the amount of such loan or deposit received or repaid, is leviable. The Central Board of Direct Taxes has directed that in cases where the Income-tax Officer did not initiate penalty proceedings, he should record reasons for not doing so.

The assessments of two companies for the previous year ended 31 March 1989 relevant to

the assessment year 1989-90 were completed in February 1990 and March 1990 respectively. It was noticed from the prescribed audit reports filed with the returns of income that the assessees had accepted loans/deposits in cash amounting to Rs.6.54 lakhs **i.e.,** in excess of the prescribed limit of Rs.10,000. Similarly one of the companies had repaid loan/deposit in cash amounting to Rs.2.68 lakhs. The assessing officer neither initiated prosecution proceedings nor recorded any reasons for non initiating action. The total fine leviable in the two cases on successful completion of the proceedings worked out to Rs.9.22 lakhs.

The department has accepted the audit observation.

2. Under the provisions of the Income-tax Act, 1961 every assessee whose total sales turnover or gross receipts as the case may be in business exceeded forty lakhs rupees, in any previous year should get his accounts audited by an authorised accountant before the due date for submission of the return of income and obtain before that date the report of such audit in the prescribed form. The due date for filing the return of business income has been prescribed as 30 June or 31 July of the assessment year depending on whether the accounts of the assessee are closed for the period upto the preceding February or March. Failure to comply with these provisions renders the assessee liable to a penalty equal to one half percent of the total sales, turnover or gross receipts or one lakh rupees, whichever is lower. In September 1975, general instructions were issued by the Board that where the assessing officer decides not to levy penalty in any case he should record the reasons for not doing so.

The assessments of seven companies for the assessment years 1985-86 and 1988-89 were completed between August 1986 and February 1990. It was noticed that the audit reports from the authorised accountant were obtained between August 1986 and August 1988 respectively even though the due dates for obtaining the audit reports for these

assessment years had expired in July 1986, July 1987 and July 1988 respectively. For failure to observe the statutory provisions the assessees were liable to penalty of rupees one lakh for each of the assessment years aggregating to Rs.9 lakhs. This was not imposed nor were any reasons therefor kept on record by the assessing officer.

Ministry of Finance have accepted the audit observation in two cases.

OTHER TOPICS OF INTEREST

Non levy of additional tax

3.53 Under the provisions of the Income-tax Act, 1961, where the profits and gains of any previous year distributed as dividends within the twelve months immediately following the expiry of the previous year by a company, not being one in which the public are substantially interested or a hundred percent subsidiary of any such company, are less than statutory percentage of the distributable income of that previous year, the company is liable to pay additional income-tax at specified rates on the distributable income as reduced by the amount of dividends actually distributed, if any.

1. On the basis of the income-tax assessment of a closely held investment company for the assessment year 1987-88 (assessment made in March 1990) the distributable income worked out to Rs.34.73 lakhs. No dividend was, however, declared by the assessee company from the distributable income for the previous year within the statutory period. Consequently, the company became liable to pay additional income-tax of Rs.15.63 lakhs which was not levied. This omission led to non-levy of additional income-tax of Rs.15.63 lakhs.

2. In the case of a company engaged in the business of construction, additional income-tax was levied for the assessment year 1984-85 in the assessment made by the Deputy Commissioner of Income-tax in March 1988, holding that the business of construction was not the business of manufacturing or processing of goods etc. However, no action

was initiated for the levy of additional income-tax while completing assessment for the assessment years 1985-86, 1986-87 and 1987-88 in March 1988, January 1989 and January 1989 respectively, although the dividends distributed during the next twelve months following the expiry of each of the relevant previous years was less than the statutory percentage. Non-levy of additional income-tax in respect of the assessment year 1985-86 was also pointed out by the Deputy Commissioner of Income-tax (Audit) in October 1988, but no action was initiated by the department. Dividends distributed in respect of the assessment years 1985-86, 1986-87 and 1987-88 were Rs.2.01 lakhs, Rs.2.93 lakhs and Rs.4.05 lakhs which were less than sixty percent of the distributable income of Rs.13.36 lakhs, Rs.16.56 lakhs and Rs.20.23 lakhs respectively. The omission resulted in non-levy of additional income-tax at 25 percent of the shortfall amounting to Rs.2.84 lakhs, Rs.3.41 lakhs and Rs.4.05 lakhs respectively.

In the case of another company deriving only share income from a firm engaged in the business of construction, dividend declared in respect of the assessment year 1987-88 was Rs.2.80 lakhs which was less than sixty percent of the distributable income of Rs.5.76 lakhs. However, no action was initiated to levy additional income-tax on completion of assessment in January 1989, while the company was liable for the levy of additional income-tax, being one not engaged in the business of manufacture or processing of goods. The omission resulted in non-levy of additional income-tax at 25 percent of the shortfall, amounting to Rs.73,952. The mistakes in the two cases resulted in non-levy of additional income-tax aggregating to Rs.11.02 lakhs.

The department has accepted the audit observation.

3. In the case of a closely held company engaged in the business of transportation , no dividends were distributed in respect of its distributable profit of Rs.15.25 lakhs

for the assessment year 1987-88, while in the case of another closely held investment company, the company had made provision for distribution of dividends of Rs.1.05 lakhs and Rs.1.35 lakhs against the distributable profits of Rs.6.45 lakhs and Rs.6.78 lakhs in respect of the assessment year 1986-87 and 1987-88 respectively. The assessees were, therefore, liable for levy of additional income-tax of Rs.3.81 lakhs (25 percent of Rs.15.25 lakhs) in the former case and Rs.2.70 lakhs and Rs.2.72 lakhs (at the rate of 50 percent of the short fall of Rs.5.40 lakhs and Rs.5.43 lakhs) in respect of the assessment years 1986-87 and 1987-88 respectively in the latter case. However, proceedings for the levy of additional income-tax were not initiated during assessment proceedings completed in March 1990, August 1989 and December 1989. The omission resulted in non-levy of additional income-tax aggregating to Rs.9.23 lakhs in two cases.

Ministry of Finance have accepted the audit observation.

4. The income-tax assessments of a closely held company for assessment years 1986-87 and 1987-88 were completed on 30 March 1989. The company did not distribute any dividends in the succeeding twelve months. The distributable income for these assessment years amounted to Rs.2.88 lakhs and Rs.3.06 lakhs and the additional income-tax leviable at the rate of 50 percent worked out to Rs.1.44 lakhs and Rs.1.53 lakhs respectively. The department did not initiate any proceedings for levy of additional income-tax even though the assessee was liable for such levy, which resulted in loss of revenue aggregating to Rs.2.97 lakhs for these two years. It was also noticed that for assessment year 1985-86, the additional incme-tax was levied on 8 March 1989 on distributable income of Rs.1.98 lakhs at the rate of 37 percent instead of at the rate of 50 percent, applicable to investment company. Thus, the additional income-tax levied for assessment year 1985-86 was short to the

extent of Rs.25,712 (Rs.98,890 minus Rs.73,178).

Change of previous year prejudicial to revenue

3.54 Under the provisions of the Income-tax Act, 1961, an assessee can change the hitherto followed previous year in respect of his business with the consent of the Income-tax Officer upon such condition as the Income-tax Officer may impose. The Central Board of Direct Taxes issued instructions in May 1971 and August 1976 requiring the Income-tax Officers to ensure that the assessee is not attempting to make use of the device of changing his previous year in a manner detrimental to revenue, including undue deferment of payment of advance tax. Where the application is made with the object of causing loss to revenue, the orders of the Commissioner of Income-tax should be obtained before granting permission to the assessee to change the previous year. The Board also specifically directed the Commissioner of Income-tax to cancel all permissions granted for change of previous year by the Income-tax Officer if they are found to be prejudicial to revnue.

A public limited company with previous year ending 31 March upto the assessment year 1984-85 sought permission for a change in the accounting year as a result of which the next accounting year covered a period of 14 months from 1 April 1984 to 31 May 1985 for the assessment year 1986-87. The department consented to the change without imposing any condition. Accordingly, no assessment was made for the assessment year 1985-86. The assessment for the assessment year 1986-87 covering an accounting period fo 14 months was completed in February 1989 for a total income of Rs.1.98 crores and income-tax was charged thereon at the rate of 50 percent and surcharge on income-tax at the rate of 5 percent. Had no change in the accounting year been permitted, the assessee company was liable to be charged with income-tax at a higher-rate of 55 percent for its income for 12 months from 1 april 1984 to 31 March 1985. The omission to safeguard the interest of the revenue in accordance with the provisions of the Act and failure to comply with the

instructions of the Board at the time of completing the assessment for the assessment year 1986-87 led to short levy of tax of Rs.8.92 lakhs.

The department has accepted the audit observation in principle.

Double allowance of tax deducted at source

3.55 Under the provisions of the Income-tax Act, 1961, credit for any deduction made from the payment to a contractor for carrying out any work, shall be given for the amount so deducted in the assessment for the assessment year for which such income is assessable, on production of the prescribed certifcate for such deduction. Further, in computing the income from business or profession, no deduction towards depreciation in respect of any motor car manufactured in or outside India and acquired after 28 February 1975 and used otherwise than in a business of running it on hire is admissible according to the provisions of the Act.

A Government corporation engaged in civil contract work was assessed on an income of Rs.119.99 lakhs for the assessment year 1981-82 in February 1985 and was allowed credit for tax deducted at source (TDS) of Rs.10.23 lakhs against total claim of TDS of Rs.11.98 lakhs. The balance of TDS credit for Rs.1.75 lakhs was not allowed for want of proper certificates. The assessment was subsequently revised in March 1985 to rectify certain mistakes, but credit for Rs.17.95 lakhs was allowed on account of TDS without any extra certificates. Further, in both the assessments aggregate deduction towards depreciation was allowed at Rs.119.98 lakhs which, **inter alia**, included depreciation on vehicles at Rs.3.18 lakhs. Out of this sum, depreciation of Rs.31,000 pertained to foreign manufactured cars. Audit scrutiny revealed (February 1990) that the extra TDS credit allowed in revised assessment of March 1985 at Rs.7.72 lakhs (Rs.17.95 lakhs instead of Rs.10.23 lakhs) was included in the credit of Rs.10.23 lakhs as allowed in the original assessment. The mistake of double allowance of credit led to short levy of tax demand by Rs.7.72 lakhs. Again the foreign manufactured

cars were acquired after the stipulated date of 28 February 1975 and were not used in the business of running them on hire for tourists and thus were not entitled to depreciation of Rs.31,000 according to the provisions of law. These mistakes led to short levy of tax demand of Rs.7.90 lakhs on which consequential short charge of interest for not paying advance tax amounted to Rs.6.28 lakhs. The aggregate short charge thus amounted to Rs.14.18 lakhs. Though the assessments were revised under the orders of various competent authorities in October 1985, October 1986, March 1987 and August 1989, the mistakes remained undetechted.

Ministry of Finance have accepted the audit observation.

Non-observance of provision of law relating to acquisition of assets

3.56 The Income-tax Act, 1961, was amended by the Finance Act, 1985 with retrospective effect from 1 April 1974 to provide that any amount paid or payable as interest in connection with the acquisition of assets relatable to any period after such assets are first put to use shall not form part of the actual cost of the assets.

In the case of an assessee private limited company, in the assessment for the assessment year 1985-86, completed in January 1988, the assessing officer allowed the capitalised interest of Rs.1.29 lakhs on purchase of machinery as revenue expenditure and also withdrew depreciation allowance of Rs.99,760 already allowed in earlier assessment years on the portion of capitalised interest. Scrutiny of earlier assessment records for assessment years 1979-80 to 1984-85 revealed that the assessee company had purchased certain machineries on deferred payment basis during the accounting periods 1977-78 and 1979-80 and interest amounting to Rs.13.83 lakhs was capitalised and added to the cost of machinery. The assessee had also claimed and was allowed deduction towards depreciation, investment allowance and tax holiday arelief of Rs.10.50 lakhs, Rs.3.46 lakhs and Rs.1.90 lakhs respectively on the capitalised amount of interest. In view of the amendment made by Finance Act 1985, an

aggregate interest of Rs.11.26 lakhs capitalised would be allowable as deduction in the respective years, while the claims of depreciation, investment allowance and tax holiday relief allowed on the enhanced value of machineries (**i.e.** on the capitalised amount) are required to be withdrawn. Omission to give due effect to the amended provisions of the Act for the assessment years 1979-80 to 1985-86 resulted in underassessment of income ofRs.4.59 lakhs with consequent short levy of tax of Rs.3.26 lakhs.

The department has accepted the audit observation.

SURTAX

As a disincentive to excessive profits a special tax called super profits tax was imposed on companies making excessive profits during the assessment year 1963-64 under the Super Profits Tax Act, 1963. This tax was replaced from the assessment year 1964-65 by a surtax levied under the Companies (Profits) Surtax Act, 1964 which was also abolished from the assessment year 1988-89. Some important mistakes noticed in the assessment and levy of surtax during the course of audit in 1990-91 in respect of past cases are detailed below.

Incorrect computation of capital

3.57 Under the provisions of the Companies (Profits) Surtax Act, 1964, surtax is leviable on the amount by which the chargeable profits of a company exceed the statutory deduction, which is an amount equal to 15 percent of the capital of the company as on the first day of the previous year or Rs.2 lakhs whichever is greater. Capital for the purpose includes the paid up share capital and reserves as on the first day of the relevant previous year. The Surtax Act lays down that any amount standing to the credit of any account in the books of a company which is of the nature of a liability or a provision, shall not be regarded as a reserve for the purpose of computation of capital.

1. In the surtax assessments of a public limited company for the assessment years 1978-79 to 1983-84 completed in January 1989 and the revised assessments for the assessment years 1975-76 and 1976-77 completed in January 1990, the assessing officer while computing the capital base for levy of surtax included therein an amount of Rs.1,617.72 lakhs representing the provision for differential excise duty treating it as reserve. Audit scrutiny (October 1990), however, revealed that the differential excise duty was exhibited as `current liability and provision' in the respective balance sheets corresponding to the 1st day of the previous years relevant to assessment years 1975-76, 1976-77 and 1978-79 to 1983-84. Due to incorrect inclusion of differential excise duty in the capital base, there was excess determination of capital by Rs.1,617.72 lakhs in those assessment years with consequent excess grant of statutory deduction by Rs.238.78 lakhs and undercharge of surtax of Rs.83.73 lakhs in aggregate.

2. It has been judicially held* in September 1981 that gratuity liability based on actuarial valuation is an ascertained liability and, therefore, is not a reserve.

A company did not provide for its gratuity liabilities amounting to Rs.2035.87 lakhs as ascertained on actuarial valuation in the accounts of the previous years relevant to assessment years 1975-76 to 1983-84. While computing the capital for the purpose of surtax for the assessment years 1975-76 to 1983-84 (assessments completed between January 1989 and January 1990), the general reserve which included these liabilities was however not reduced by the assessing officer. The omission to exclude gratuity liabilities of Rs.2035.87 lakhs from the capital base in the assessment years 1975-76 to 1983-84 resulted in the excess determination of capital by Rs.2035.87 lakhs in those assessment years with consequent undercharge of surtax of Rs.78.03 lakhs.

*** Vazir Sultan Tobacco Co. Ltd. Vs. C.I.T.(132-ITR-559)**

3. Pending receipt of demands from the Excise Department towards excise duty as per the guidelines issued by the Supreme Court in its case for the assessment years upto 1974-75, a widely held company claimed liabilities aggregating to Rs.873.11 lakhs for the assessment years 1977-78 to 1983-84 estimating the same as per such guidelines, but without providing for the same in the accounts of the previous years relevant to these assessment years. These claims which were rejected by the assessing officer were subsequently allowed on the basis of appellate orders.

As the sum of Rs.873.11 lakhs constituted ascertained liabilities and created a charge on the reserves of the assessee company, the general reserves of Rs.742.49 lakhs forming part of the capital of Rs.1247.95 lakhs as at 1 October 1982, the first day of the computation period relevant to the assessment year 1984-85 were to be reduced by these liabilities. Audit scrutiny (August 1990), however, revealed that in the surtax assessment for the assessment year 1984-85 made in April 1987 (revised in March 1989), the entire reserves were included by the Deputy Commissioner of Income-tax in the computation of capital without such reduction. The mistake led to under-assessment of chargeable profits by Rs.78.03 lakhs involving a short levy of surtax of Rs.39.35 lakhs (including interest of Rs.11.93 lakhs leviable for non-filing of advance surtax estimate).

4. The Central Board of Direct Taxes, in their instructions issued in January 1968, clarified that any sum of money available for payment or discharge of liability and taken into a reserve account cannot be treated as reserve for the purpose of Surtax Act, but the amount standing to the credit of these accounts can only be regarded as fund.

Further, under the rules for the computation of capital for the purpose of the Surtax Act, where a part of the income, profits and gains of a company is not includible in its total income as computed under the Income-tax Act,

its capital for the purpose of surtax is required to be diminished by an amount proportional to the amount of income, profits and gains excluded from the total income.

The surtax assessments of a non-resident shipping company for the assessment years 1981-82 to 1984-85 were completed by the Inspecting Assistant Commissioner (Assessment) in February 1986 with deficiency, and surtax payable was determined as nil. Audit scrutiny, made in October 1988, revealed that Reserve for `Hulls and Machinery' and Reserve for Crews' illness and Cargo claims' were treated as reserve for the purpose of computation of capital base for the assessment years 1981-82 to 1984-85. As these reserves were nothing but monies kept by the company for payment or discharge of unexpected claims, the amounts standing to the credit of these reserves could only be treated as fund as clarified by the Board and could not be treated as reserve for the purpose of computation of capital.

Further, as the world profit and loss accounts of the non-resident shipping company sustained world loss, the assessee company pleaded for non-reduction of capital and the same was accepted by the assessing officer. But the assessee was a non-resident shipping company and only 7.1/2 percent of its Indian receipts was being assessed to Indian income-tax, the ratio of the assessed Indian income to assessable world income was only .0425, .0485 and .0562 for the assessment years 1981-82 to 1983-84 respectively and for the purpose of computation of capital for surtax, proportionate reduction with reference to income not so included in the total income, was required to be made. It was, however, noticed that no such reduction of capital was made. The capital, after exclusion of Reserve for Hulls and Machinery' and Reserve for Crews illness and Cargo claims' and after reduction in the aforesaid ratio, therefore, amounted to Rs.1.43 lakhs, Rs.1.34 lakhs, Rs.1.46 lakhs and Rs.22.43 lakhs (capital for the assessment year 1984-85 not reduced for want of relevant world profit and loss account), and the net chargeable profits

worked out at Rs.26.17 lakhs, Rs.32.51 lakhs, Rs.15.13 lakhs and Rs.13.80 lakhs for the assessment years 1981-82 to 1984-85 respectively. The mistake resulted in an aggregate underassessment of net chargeable profits of Rs.87.61 lakhs with consequent undercharge of surtax of Rs.51.51 lakhs including non-levy of interest of Rs.16.67 lakhs for the assessment years 1981-82 to 1984-85.

The department has accepted the audit observation.

5. The Act further provides that in computing the capital where the provision for taxation in the accounts falls short of the amount which should have been reasonably provided, such short-fall shall be reduced from the capital. But there is no provision in the Act to make any addition to the capital on account of the excess provision made in the accounts over and above the actual tax liability.

The surtax assessments of a widely held company for the assessment years 1977-78 to 1979-80 were initially completed in January 1978, October 1978 and January 1980 and revised in May 1987, August 1987 and August 1987 assessing the chargeable profits at Rs.193.62 lakhs, Rs.128.51 lakhs and Rs.146.10 lakhs respectively. Audit scrutiny in January 1989 revealed that during the previous years relevant to the assessment years 1976-77, 1977-78 and 1978-79, the company transferred to its general reserve the sums of Rs.10.16 lakhs, Rs.37.30 lakhs and Rs.13.60 lakhs being development rebate reserve no longer required. As these sums had been allowed as deduction in computing the taxable income, the general reserve taken for the purpose of computation of capital for surtax for the assessment year 1977-78, 1978-79 and 1979-80 should have been reduced by Rs.10.16 lakhs, Rs.47.46 lakhs and Rs.61.06 lakhs respectively. This was not done. Further, the provision made in the accounts over and above the actual tax liabilities amounting to Rs.158.87 lakhs for assessment year 1977-78, Rs.181.59 lakhs for 1978-79 and

Rs.250.27 lakhs for 1979-80 were added to the capital base. As the Act provides only for the deduction from the capital base in respect of any short fall in the provision made for tax, the addition of excess provision to the capital base was not in order. These mistakes resulted in excess computation of capital base by Rs.169.03 lakhs, Rs.229.05 lakhs and Rs.311.33 lakhs for assessment years 1977-78 to 1979-80 involving additional tax demand of Rs.60.44 lakhs.

The department has accepted the audit observation.

6. The surtax assessments of a widely held company for the assessment years 1983-84 and 1984-85 were completed by the Deputy Commissioner of Income-tax in July 1986 and December 1986 on a chargeable profits of Rs.141.83 lakhs and Rs.171.16 lakhs respectively. Audit scrutiny in February 1989 revealed that while computing the capital base as at 1 April 1982 and 1 April 1983 additions of Rs.273.69 lakhs and Rs.476.39 lakhs representing provision made in the accounts over and above the actual tax liabilities were made to the capital base for the assessment years 1983-84 and 1984-85 respectively. As the Act provides only for the deduction from the capital base in respect of any shortfall in the provision made for taxation, the addition of excess provision to the capital base was not in order. The mistake resulted in short computation of chargeable profits by Rs.41.05 lakhs and Rs.71.45 lakhs with a consequential aggregate short levy of surtax of Rs.50.63 lakhs for the two assessment years.

The department has accepted the audit observation.

7. It has been judicially held* that if the amount of depreciation provided in the books of an assessee company for a particular year was less than the amount of depreciation actually allowed by the assessing officer for

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* **C.I.T. Bombay Vs. Zenith Steel Pipes Ltd. (112-ITR-215)**

computation of its income under the Income-tax Act, then the difference between these two amounts has to be deducted from the amount standing to the credit of its general reserve, while computing the capital employed for surtax purposes.

In the surtax assessments of a public limited company for the assessment years 1979-80 to 1983-84 as revised in January 1989, it was noticed that as on the last day of the previous years relevant to the assessment years 1978-79 to 1982-83, the assessee company was allowed deductions by way of depreciation and weighted deduction in export market development allowance to the extent of Rs.1,617.04 lakhs as against a sum of Rs.1,365.42 lakhs provided in the book leaving a balance of Rs.251.62 lakhs which was fully allowed as deduction in the income-tax assessments in excess of provision. The difference of Rs.251.62 lakhs in aggregate between the depreciation and export market development allowance already allowed in income-tax assessments and that debited to the accounts of the assessee company was not reduced from the general reserve. The amount transferred to the general reserve was included in the capital base without effecting reduction in capital by progressive short provision of Rs.576.28 lakhs. The omission resulted in the excess computation of capital by Rs.576.28 lakhs in the assessment for the assessment years 1979-80 to 1983-84 with consequent excess grant of standard deduction by Rs.85.84 lakhs in the said years with undercharge of surtax of Rs.29.37 lakhs.

8. The Surtax Act also lays down that share premium is includible as part of the paid up capital only if the same is received in cash.

In the surtax assessments of a public limited company for the assessment years 1975-76 to 1983-84 (assessments for the assessment year 1977-78 to 1983-84 completed in January 1989 and for the assessment years 1975-76 and 1976-77 revised in January 1990), the assessing officer while computing th capital base for levy of surtax included therein an

amount of Rs.44.10 lakhs representing share premium not received in cash but created by accounts adjustment as on the first day of the relevant previous years. The mistake resulted in excess determination of capital by Rs.396.90 lakhs for those assessment years with consequent excess grant of standard deduction of Rs.55.13 lakhs and undercharge of surtax of Rs.18.08 lakhs.

9. It has also been judicially held* that the mere capitalisation of the reserves and issue of bonus shares subsequent to the first day of the previous year do not enable an assessee to obtain an increase in the capital computed as on the first day of the previous year.

While computing the capital base of a government company for the assessment year 1978-79 in October 1978 (revised in January 1987), an amount of Rs.175.07 lakhs was added towards the proportionate increase in the share capital of the assessee company after the first day of the previous year. Records revealed that the share capital of the company had been increased by capitalising an amount of Rs.5871.74 lakhs from out of general reserve which had been included in capital computation. As whole of the amount capitalised had been included in the overall capital computation, the further addition by way of proportionate increase in share capital was not in order. The mistake led to short levy of surtax of Rs.16.43 lakhs including interest of Rs.4.62 lakhs allowed to the assessee.

10. Any sums included under the head Current liabilities' and provisions in the balance sheet cannot be considered as reserves for computing the capital employed. It has been judicially held that the liability to pay income-tax is a present liability though the tax becomes payable after it is quantified in accordance with the ascertainable data, which gives it the character of a perfected debt and not a contingent liability. It has also been held

* Additional Commissioner of Surtax Vs. Food Specialities (1981) (129-ITR-781 Delhi)

that an amount set apart by the company for liability to taxation in respect of the profits earned will have to be regarded as a provision for a known and existing liability, the quantification whereof has to be done later. The amount set apart would, therefore, be a provision and cannot be regarded as a reserve.

In the surtax assessment of a widely held company for the assessment years 1981-82 to 1985-86 completed by the Deputy Commissioner of Income-tax between June 1986 and January 1989, the assessing officer erroneously included in the capital base, excess provisions of tax amounting to Rs.41.29 lakhs, Rs.34.71 lakhs, Rs.42.68 lakhs, Rs.50.66 lakhs and Rs.61 lakhs respectively treating those as reserves. The mistakes led to excess grant of statutory deduction of Rs.6.19 lakhs, Rs.5.21 lakhs, Rs.6.40 lakhs, Rs.7.60 lakhs and Rs.9.15 lakhs in the assessment years 1981-82, 1982-83, 1983-84, 1984-85 and 1985-86 respectively resulting in short levy of surtax of Rs.15.08 lakhs in aggregate (including interest of Rs.2.70 lakhs).

Mistake in computation of chargeable profits for surtax

3.58 Under the Companies (Profits) Surtax Act, 1964, surtax is leviable on the amount by which the chargeable profits of a company exceed the statutory deduction which is an amount equal to 15 percent of the capital of the company as on the first day of the previous year or Rs.2 lakhs, whichever is greater.

1. Further, under the Act the chargeable profits of any year are computed with reference to total income assessed for levy of income-tax for that year after making certain prescribed adjustments. The total income assessed as reduced by income-tax payable on the said income is the basis for computation of chargeable profits of a company for the purpose of levy of surtax. Income-tax payable means the gross tax as reduced by any relief, rebate or deduction allowable under the Income-tax Act or the

relevant annual Finance Act. Under the Companies Deposits (Surcharge on Income-tax) Scheme, 1985 surcharge which is levied on income-tax is not payable by a company if the company deposits with the Government an amount equal to the surcharge.

(i) In the reassessment of a government company for the assessment year 1977-78 completed in May 1986, the assessing officer disallowed a sum of Rs.141 lakhs deposited by the assessee under the Company's Deposits (Surcharge on Income-tax) Scheme, 1985, in lieu of surcharge payable but omitted to add back the similar amount which was not deducted from income-tax liability for computing chargeable profits. The mistake resulted in short assessment of chargeable profit by Rs.141 lakhs with consequential short levy of surtax by Rs.56.40 lakhs.

(ii) Under the provisions of the Finance Act, 1984, the liability for surcharge on income-tax reduced by one half, if the amount deposited in Industrial Development Bank of India during the financial year 1983-84 payable and equals or exceeds one half of the surcharge is reduced to the extent to which the amount is deposited in Industrial Development Bank of India during the financial year 1984-85.

In the income-tax assessments of a company for the assessment years 1984-85 and 1985-86, the liability for surcharge on income-tax was reduced by Rs.4.75 lakhs and Rs.8.25 lakhs respectively being amounts deposited in the Industrial Development Bank of India during the relevant financial years. In the surtax assessments for assessment years 1984-85 and 1985-86, completed by the Deputy Commissioner of Income-tax in March 1988, the assessing officer, however, while working out the net tax payable for the purpose of computation of chargeable profits omitted to take into account the aforesaid reduction in the liability for surcharge. The mistake resulted in underassessment of net chargeable profits leading to short levy of surtax aggregating to Rs.6.33 lakhs (including interest for

short payment of advance surtax) for the assessment year 1984-85 and 1985-86.

2. Consequent upon the under-assessment of income pointed out by audit (October 1990) in the cases of income-tax assessments of three assessee companies for the assessment years 1985-86 and 1986-87, assessments of which were completed by the Deputy Commissioner of Income-tax between February 1987 and September 1987, the chargeable profit already calculated required revision for calculation of surtax. Accordingly, the surtax leviable worked out to Rs.101.48 lakhs in respect of the three companies for the assessment years 1985-86 and 1986-87.

Omission to make surtax assessment

3.59 Under the Companies (Profits) Surtax Act, 1964, there was no statutory time limit for completion of surtax assessments. Pursuant to the recommendations of the Public Accounts Committee in para 6.7 of their 128th Report (Fifth Lok Sabha) the Central Board of Direct Taxes issued instructions in October 1974 that surtax assessment proceedings should be initiated alongwith the income-tax assessments. The Board further laid down that the surtax assessment should not be kept pending on the ground that the additions made in the income-tax assessments were disputed in appeal and the time lag between the date of completion of income-tax assessments and surtax assessments should not ordinarily exceed a month unless there were special reasons justifying the delay.

Noticing the persistent delay or omission in completing the surtax assessments despite the above recommendations and issue of instructions by the Board, the Public Accounts Committee recommended in Paragraphs 3.3 to 3.10 of their 85th Report (Seventh Lok Sabha) that a statutory time limit for completion of surtax assessments under the Surtax Act should be prescribed. The need for a statutory time limit for completion of surtax assessment was again stressed by the Public Accounts Committee in Para 1.6 of their 193rd Report (Seventh Lok Sabha).

During the course of test audit it was noticed in 43 cases that either the assessee company had not filed the surtax return or the department had not initiated any proceedings for making surtax assessments. The omission in not making surtax assessments in these cases resulted in a short levy of surtax of Rs.898.58 lakhs. The following cases are illustrative of the omissions:

Sr. No.	Commissioner's charge Assessment year	Date of completion of income-tax assessment	Total income assessed (in lakhs or rupees)	Surtax
01.	Delhi-I 1985-86	February 1988	--	155.94
02.	Delhi-II 1984-85	August 1986	--	131.74
03.	Coimbatore 1985-86 and 1986-87	March 1988 (Revised in July 1989) and March 1989 (Revised in June 1989 and March 1990)	479.91 492.24	142.35
04.	Delhi II 1985-86	October 1987	--	74.02
05.	Thiruvananthapuram 1983-84	March 1986 (Revised in May 1986)	333.82	55.09
06.	Delhi II 1985-86	July 1986	280.03	37.61
07.	Delhi II 1985-86	February 1988	--	36.94
08.	Tamil Nadu II 1985-86	March 1988	558.35	31.20
09.	West Bengal IV 1986-87	November 1989	184.56	24.79
10.	Lucknow 1987-886	March 1990	149.77	19.15
11.	Allahabad 1983-84 to 1985-86	27 March 1986 27 March 1987 18 March 1988	46.95 79.74 102.52	15.15

Ministry of Finance have accepted the audit observations in respect of four cases.

Omission to revise surtax assessment

3.60 The Companies (Profits) Surtax Act, 1964, provides that where, after completion of surtax assessment, the total income on which it was based, is varied as a result of any revision orders passed under the Income-tax Act, 1961, or to give effect to appellate order, the assessing authority has to determine afresh the surtax payable or refundable, as the case may be.

The surtax assessment of a widely held company for the assessment year 1984-85 was completed in June 1987 with reference to total income of Rs.240.85 lakhs assessed under the Income-tax Act in January 1986. The total income of the company was subsequently revised to Rs.288.95 lakhs in March 1990 following the orders of the Commissioner of Income-tax. It was, however, noticed in audit (September 1990) that no action was taken by the assessing officer to revise the surtax assessment even after 6 months of the completion of revised income-tax assessment which resulted in postponement of levy and realisation of additional surtax demand of Rs.8.12 lakhs.

Non levy of interest on short payment of advance surtax

3.61 Under the provisions of the Companies (Profits) Surtax Act, 1964, effective from 1 April 1981 every company is required to send to the assessing officer an estimate of the advance surtax payable and to pay the amount as per the estimate in three instalments on the dates prescribed. Where in any financial year, a company has paid advance surtax on the basis of its own estimate and the advance surtax so paid is less than eighty three and one-third percent of the assessed surtax, simple interest at the prescribed rate is payable by the company on the amount by which the advance surtax paid falls short of the assessed surtax from the first day of next financial year to the date of regular assessment.

1. The regular surtax assessment of a public limited company for the assessment years 1983-84 and 1984-85 were completed by

the Deputy Commissioner of Income-tax in March 1988 (revised in March 1989) and surtax of Rs.26.82 lakhs and Rs.61.35 lakhs on net chargeable profits of Rs.73.33 lakhs and Rs.161.14 lakhs respectively was levied. The assessee company had paid estimated advance surtax of Rs.17.08 lakhs and Rs.49.78 lakhs in the financial years corresponding to the respective assessment years which fell short of 83.33 percent of the assessed surtax. As such the assessee company was liable to levy of interest for short payment of advance surtax. It was, however, noticed in audit (February 1991) that no interest was levied by the department. The omission led to non-levy of interest aggregating to Rs.13.37 lakhs for assessment years 1983-84 and 1984-85.

2. The surtax assessment of a company for the assessment year 1986-87 was completed in February 1990 on a net chargeable profit of Rs.97.83 lakhs with a surtax demand of Rs.38.80 lakhs. The assessee paid advance surtax, during the specified period, amounting to Rs.29.44 lakhs which fell short of eighty three and one third percent of the assesseed surtax of Rs.38.80 lakhs. The assessee was, therefore, liable to levy of interest to the extent ofRs.5.38 lakhs which was not so levied. The omission resulted in non-levy of interest of Rs.5.38 lakhs for short payment of advance surtax.

Ministry of Finance have accepted the audit observation.

CHAPTER 4

INCOME TAX

4.01 Income-tax collected from persons other than companies is booked under the Major Head `0021 Taxes on income other than corporation-tax'. Eighty five percent of the net proceeds of this tax, except in so far as these are attributable to Union emoluments, Union Terrirotires and Union surcharge is assigned to the States in accordance with the recommendations of the Finance Commission.

4.02 The trend of receipts from income-tax during the last five years was as follows:

Year	Total collection of all Direct Taxes	Amount of Income-tax	Percentage of Income-tax to total collection
	(In crores of rupees)		
1986-87	6,236.46	2,878.97	46.16
1987-88	6,757.18	3,192.43	47.25
1988-89	8,828.76	4,241.24	48.04
1989-90	10,007.78	5,008.98	50.05
1990-91*	11,028.94	5,375.34	48.74

4.03 The number of assessees (other than companies) borne on the books of the Income-tax department during the last five years was as follows:

As on 31 March	**Number**	**Average collection of taxes (per capita) (in thousands of rupees)**
1987	61,84,262	4.65
1988	64,37,826	4.95
1989	67,15,127	6.31
1990	69,16,640	7.24
1991*	73,22,010	7.34

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* Provisional

4.04 The following table indicates the progress in the completion of assessments and collection of demand under income-tax (excluding corporation tax) during the last five years.

Year	No. of assessments		Percentage of pendency to total cases due for disposal	Amount of demand		Percentage of arrears to total collection
	Completed during the year	Pending at the close of the year		Collected during the year (In crores of rupees)	In arrears at the close of the year	
1986-87	69,82,419	13,71,247	16.41	2,878.97	800.08	27.79
1987-88	63,75,745	10,53,602	14.18	3,192.43	987.79	30.94
1988-89	60,51,670	9,11,983	13.10	4,241.24	1,178.67	27.79
1989-90	55,93,738	11,36,260	16.88	5,008.98	1,409.99	28.15
1990-91*	62,68,326	12,28,905	16.39	5,375.34	1,534.59	28.55

4.05 Altogether 379 draft paragraphs involving revenue effect of Rs.17.26 crores categorised under the various provisions regarding computation of income and tax were sent to Ministry of Finance for comments. Out of these 78 important cases illustrating the mistakes are given in the following paragraphs. These audit observations were referred to the Ministry of Finance for comments during January 1991 to July 1991. The Ministry of Finance have accepted the observations in 27 cases. Out of these 12 cases were checked by the Internal Audit of the department.

Avoidable mistakes in computation of income and tax

4.06 Underassessments of tax of substantial amounts on account of avoidable mistakes, attributable to negligence on the part of assessing officers were reported in the Audit Reports year after year. Despite this and the Government issuing repeated instructions such mistakes continue to occur. 3 representative cases involving short levy of tax of Rs.45.16 lakhs are given below:

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* Provisional

Sr. No.	State/ Commissioner's charge/ Assessee	Assessment years	Nature of mistake	Tax effect/ Financial implication (In lakhs of rupees
01.	Madhya Pradesh/ A/ Co-operative Society (AOP)	1987-88	Omission to disallow a sum of Rs.1 crore out of the 'Provisions' of Rs.4.62 crores, as decided in the assessment order. Excess carry forward of losses of earlier years by Rs.1 crore.	40.00 (Potential)
02.	Calcutta/ B/ Registered Firm	1984-85	Book reduction in the value of plant and machinery by Rs.4.12 lakhs on its revaluation erroneously allowed as deduction.	2.63
03.	Bombay/ C/ Registered Firm	1986-87	Mistake in computation of tax at Rs.11.10 lakhs instead of Rs.13.27 lakhs	2.53 (including interest)

The department has accepted the audit observations in two cases.

Application of incorrect rate of tax

4.07.1 The Income-tax Act 1961, provides that income-tax is chargeable for every assessment year in respect of the total income of the previous year of a person according to the rates prescribed under the particular Finance Act.

(i) The assessment of an individual assessee for the assessment year 1987-88 was completed in March 1990 at a total income of Rs.7.20 lakhs. As per tax rate applicable to an individual for the relevant assessment year, the assessee was liable to pay tax of Rs.3.39 lakhs. Instead the assessee was incorrectly charged tax of Rs.1.59 lakhs at the tax rate applicable to a registered firm. The mistake resulted in short levy of tax of Rs.2.88 lakhs including interest of Rs.0.28 lakhs and Rs.0.79 lakhs for belated submission of

return and short payment of advance tax respectively.

Ministry of Finance have accepted the audit observation.

(ii) An unregistered firm was levied tax of Rs.1.74 lakhs on a total income of Rs.3.89 lakhs for the assessment year 1985-86 assessed in March 1990 instead of the correct amount of tax of Rs.2.19 lakhs leviable at the prescribed rate. Moreover, the department wrongly calculated interest of Rs.0.76 lakhs and Rs.0.67 lakhs instead of the correct amounts of Rs.1.61 lakhs and Rs.1.53 lakhs for non-payment of advance tax and for belated submission of return respectively. The mistakes resulted in aggregate undercharge of tax of Rs.2.16 lakhs including interest.

(iii) The assessment of a firm for the assessment year 1988-89 was completed in December 1989 on a taxable income of Rs.7.24 lakhs. The assessee firm was denied continuation of registration as the firm did not file application for the same. The assessing officer, therefore, decided to treat the assessee firm as an unregistered firm. The tax payable by the assessee firm in the status of an unregistered firm was Rs.3.58 lakhs. However, the department levied tax of Rs.1.68 lakhs only, treating the assessee as a registered firm contrary to the recordings in the assessment order. The mistake resulted in short levy of tax alone of Rs.1.91 lakhs.

(iv) In the assessment of an assessee individual for the assessment year 1986-87 completed in March 1989, the income was determined at Rs.3.08 lakhs on which income-tax was incorrectly calculated at Rs.59,898 as applicable to registered firm instead of Rs.1.33 lakhs. This involved short demand of tax of Rs.73,307. There was also consequent undercharge of interest of Rs.12,720 for late filing of return of income and Rs.28,771 for non-filing of an estimate of advance tax. The mistake thus resulted in total short demand of Rs.1.15 lakhs.

Ministry of Finance have accepted the audit observation.

2. Under the provisions of Income-tax Act, 1961, where any business income of the trust is not exempted, tax is chargeable on such income in the hands of the trust at the maximum marginal rates as applicable to the highest slab of income in the case of an Association of persons' as specified in the Finance Act of the relevant year.

The income of a trust for the assessment years 1987-88, 1988-89 and 1989-90 (assessments completed in January 1990 and March 1990) was computed at Rs.6.32 lakhs, Rs.5.55 lakhs and Rs.6.29 lakhs respectively. The assessee trust derived its income from business and was, therefore, chargeable to tax at maximum marginal rate. However, the tax was not computed correctly. While there was a mistake in the computation of tax for the assessment year 1987-88, tax was computed at rates applicable to a registered firm for the assessment years 1988-89 and 1989-90. The aggregate tax leviable for the three years correctly worked out to Rs.9.37 lakhs as against Rs.5.64 lakhs worked out by the department. The mistake resulted in short levy of tax of Rs.4.94 lakhs including interest of Rs.19,731 for late filing of the returns and Rs.1.01 lakhs for short payment of advance tax.

Mistake in computation of trust income

4.08 Under the Income-tax Act, 1961, before its amendment with effect from 1 April 1989, voluntary contributions received by a charitable or religious trust or institution without any specific direction that these will form part of the corpus of the trust or institution, shall be the income of the trust or institution.

In the case of an assessee public charitable trust (AOP) having various fund accounts during the previous year relevant to assessment year 1985-86, a sum of Rs.3.24 lakhs was transferred from the specific fund account known as `Rajendrasuri Sevadhyay Mandir Maken Fund' to the corpus fund of the trust. The fund was created out of donation

from public on appeal for the specific purpose of constructions of Rajendrasuri Mandir. Scrutiny of the records revealed that after completion of construction of the Mandir, the surplus amount of Rs 3.24 lakhs was transferred to the corpus fund of the trust and exemption was allowed in the assessment completed in September 1987, treating the amount as forming part of the corpus of the trust. As the donations was collected for a specific purpose it could be treated as corpus only when there was specific directions of donors in this regard. Moreover, the determination of the corpus should always be dependent on specific directions, and therefore, the sum so transferred should not have been treated as corpus of the trust. This irregular grant of exemption resulted in underassessment of income of Rs.3.24 lakhs with a short levy of tax of Rs.1.86 lakhs.

Ministry of Finance have accepted the audit observation.

Mistake in deduction of tax at source from salaries

4.09 According to the instructions issued by the Central Board of Direct Taxes regarding deduction of tax at source from income chargeable under the head `salaries', the employers are required to compute the correct taxable income of the assessees by applying the provisions of the Income-tax Act/Rules and deduct the correct amount of tax leviable thereon and furnish returns annually to the income-tax authorities setting forth the particulars of such tax deducted at source from their employees and its credit to the Government.

A scrutiny (February 1990) of the annual returns for the financial year ended 31 March 1988 filed by 19 employers revealed mistakes in the computation of tax in 89 cases which resulted in short deduction of tax of Rs.1.11 lakhs including Rs.23,980 towards interest for non-deduction of tax at source.

The department has accepted the audit observation.

Incorrect computation of income from house property

4.10 Under the provisions of the Income-tax Act 1961, the annual letting value of the property is chargeable to income-tax under the head `income from house property'. The income is to be computed on a notional basis and not necessarily with reference to actual receipts.

The assessments of an individual for the assessment years 1985-86 to 1988-89 were completed in July 1987, September 1988, January 1989 and March 1989 respectively adopting the rent, as returned by the assessee, at Rs.4,000 per month from a factory premises let out to the assessee's sons. Audit scrutiny in July 1989 revealed that for the purpose of wealth-tax assessment for the assessment year 1982-83 the property was referrred to the departmental valuer who fixed the value at Rs.28.73 lakhs under land and building method, pointing out specifically that the rent received from the sons of the assessee did not reflect the market rent. On the basis of this value, the department fixed the value of the property at Rs.45.50 lakhs for assessment year 1985-86. Since the rent received was far less than the market rent as pointed out by the departmental valuer, the department should have determined the market rent and adopted it in the assessments in the place of actual rent received. Omission to do so resulted in under assessment of income by Rs.60,000 each year, even if a minimum of 6 percent of the capital cost was adopted as rent receivable.

The department revised the assessments in March 1990 fixing the net annual income from the property at Rs.1.40 lakhs for assessment years 1985-86 and 1986-87, at Rs.1.47 lakhs for assessment year 1987-88 and at Rs.1.81 lakhs for assessment year 1988-89 and raised additional demand aggregating to Rs.2.87 lakhs for four assessment years.

INCORRECT COMPUTATION OF BUSINESS INCOME

Incorrect allowance of liability

4.11. Under the provisions of the Income-tax Act, 1961, as applicable with effect from the assessment year 1984-85 and onwards, a deduction otherwise allowable under the Act

in respect of any sum payable by the assessee by way of the tax or duty under law for the time being in force shall be allowed in computing the business income of that previous year in which such sum is actually paid by him and not merely on the basis of accrual of the liability. It has been judicially held by the Supreme Court[1] (October 1972 and November 1974) that the amount of sales-tax collected by the trader in the course of business constitutes his trading or business receipts and as such liable to be included in his business income. It has also been judicially held (March 1983) that if a receipt is a trading receipt, the fact that it is not so shown in the accounts books of the assessee would not prevent the assessing authority from treating it as trading receipt.

In the assessment of 4 assessees, registered firms, for the assessment years 1986-87 to 1989-90 completed between August 1986 and March 1990, the payments of benefit to staff, entry tax and sales-tax amounting to Rs.104.91 lakhs charged to profit and loss account but not actually paid to the Government in the relevant accounting year and shown as liability respectively in the balance sheet were not disallowed and added back to income liable to tax. Omission to disallow the unpaid amounts of statutory liability led to undercharge of tax aggregating to Rs.72.57 lakhs including short payment of advance tax.

The department has accepted the audit observation in one case.

Ministry of Finance have accepted the audit observation in two cases.

Mistake in valuation of closing stock

4.12.1 In order to determine the profits from business an assessee who maintains accounts on mercantile basis, may choose to value the closing stock of his business every year at cost or market price whichever is

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1. Chowringhee Sales Bureau (P) Ltd. Vs. C.I.T. (1973) (87-ITR-542 - SC)
Sinclare Murry and Co. (P) Ltd. Vs. C.I.T. W.B. (97-ITR-615 - SC)

lower. It has been judicially held[2] in September 1980 that the privilege of valuing closing stock in a consistent manner would be available only to a continuing business and that it cannot be adopted where a business comes to an end when the stock on hand should be valued at the market price in order to determine the true profits of business on the date of closure of business. The Ministry of Law had confirmed this position in August 1982 and March 1984. The Central Board of Direct Taxes has not, however, issued any instructions in this regard for the guidance of the assessing officers. It has been judicially held[3] that conversion of a proprietary concern into a partnership and conversion of a proprietory concern into a company are treated as sale or transfer. In such cases the entity of proprietary or partnership concern ceases on the date of conversion and a new entity comes into being for the purpose of income-tax though the business is continued to be carried on.

(i) During the previous year relevant to the assessment year 1985-86 a registered firm was converted into a company on 5 February 1984. On the date of discontinuance of business, the firm had closing stock of raw hides and chemicals worth Rs.116.74 lakhs at cost, which were taken over by the company. The assessing officer while completing assessment for assessment year 1985-86 in December 1987, adopted the value of closing stock at cost price, **i.e.** Rs.116.74 lakhs, instead of at market price to ascertain the true profit of the firm on the date of dissolution. By adopting the gross profit rate of 9.5 percent as per selling price of raw hides and chemicals (in the absence of details), the market value of closing stock would work out to Rs.127.83 lakhs. The mistake resulted in under-assessment of income by Rs.11.09 lakhs.

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2. C.I.T. Vs. A.L.A. Firm (102-ITR-622-Madras)
3. Addl. Commissioner of Income-tax, Mysore Vs. M.A.J. Vasanaik (116-ITR-110-Karnataka)
   Commissioner of Income-tax Vs. Shanti Lal Rugnathji Desai (163-ITR-245-Gujarat)

Further, in the previous year relevant to the assessment year 1985-86, the firm transferred capital assets worth Rs.43.93 lakhs at its book value to the company. The firm was allowed depreciation on assets on the written down value as on first day of the previous year at Rs.3.31 lakhs, to the extent of available profits which resulted in excess allowance of depreciation to that extent. The aggregate underassessment of income after allowing other admissible deductions worked out to Rs.12.75 lakhs resulting in short levy of tax in the hands of firm and its five partners at Rs.9.52 lakhs, including interest for short payment of advance tax.

The department has accepted the audit observation.

(ii) During the previous year relevant to the assessment year 1983-84, a proprietory concern closed its business on 31 December 1982 and a private limited company took over the said business from 1 January 1983. Audit scrutiny made in September 1989 revealed that while completing the assessment for the assessment year 1983-84 of the proprietory concern in November 1988, the assessing officer adopted the value of closing stock at cost price of Rs.13.35 lakhs as returned by the assessee, instead of valuing it at market price i.e. at Rs.16.18 lakhs, which resulted in under-assessment of income of Rs.2.83 lakhs with consequent undercharge of tax of Rs.4.26 lakhs (including short levy of interest of Rs.2.39 lakhs for late filing of return and non-filing of estimate of advance tax) for the assessment year 1983-84.

The department has accepted the audit observation.

(iii) In the case of two firms which were dissolved in the previous years relevant to the assessment years 1987-88 and 1989-90, the assessments were made in November 1989 and March 1990, accepting the value of closing stock at Rs.40.37 lakhs and Rs.28.57 lakhs, as shown in the respective returns, at cost price. The market price of stock on hand was not taken into account to determine the true

profits on dissolution. In the absence of details regarding market price, the increase in the value of the closing stock at gross profit rate of 10 percent in one case and 6.02 percent in the other would be Rs.4.04 lakhs and Rs.1.77 lakhs respectively, which was assessable as profits of the firms, but the same was not considered for inclusion in the total income of the assessees resulting in short levy of tax aggregating to Rs.2.08 lakhs in the case of firms and their partners.

(iv) During the previous year relevant to the assessment year 1989-90, a registered firm was dissolved in July 1988 and its business was taken over by a company. Its accounts were closed adopting the value of the stock at Rs.18.03 lakhs at cost price. The assessment of the firm for the assessment year 1989-90 was completed in February 1990 accepting the value of the closing stock as returned instead of valuing at market price. It was pointed out in audit (October 1990) that the fair market value of the closing stock could be determined by adopting the gross profit ratio of 18.61 percent (in the absence of details regarding market value of the stock). On this basis, the value of the closing stock should have been taken at Rs.21.39 lakhs. Omission to adopt this value resulted in underassessment of income by Rs.3.36 lakhs and short levy of tax of Rs.2.05 lakhs in the hands of the firm and partners.

Incorrect allowance of provisions

4.13. Under the Income-tax Act 1961, any expenditure laid out or expended wholly and exclusively for the purpose of business or profession shall be allowed in computing the business income of an assessee, provided the expenditure is not of a capital nature or personal expenses of the assessee. A provision made in the accounts for a liability which has accrued or a liability known to exist is an admissible deduction, while other provisions if any made towards

liabilities which are contingent in nature do not qualify for deduction.

(i) In the assessment of an assessee co-operative society for the assessment year 1985-86 completed in February 1988, it was noticed that a deduction of Rs.25.10 lakhs being provisions towards compensation claims of customers pending settlement, was allowed. Since this was only a provision to cover a contingent liability, the same was required to be disallowed. The omission to do so resulted in under assessment of income of Rs.25.10 lakhs with short levy of tax of Rs.10.54 lakhs.

(ii) In the case of assessments of two co-parceners of a Hindu undivided family for the assessment year 1981-82 which were completed in February 1984 it was noticed that the claims of the assessees towards contingent liability being share of interest amounting to Rs.1.18 lakhs in each case payable on the excess amount of compensation received by the Hindu undivided family from the State Government were allowed as claimed by the assessee despite a stay order (January 1982) granted by the High Court of the State. The incorrect deduction resulted in short computation of income of Rs.1.18 lakhs in each case, with consequential total short levy of Rs.2.31 lakhs in the case of two assessees.

The department has accepted the audit observation.

Mistake in computation of business income of contractors

4.14 Under the provisions of Income-tax Act, 1961, where the Income-tax Officer is not satisfied about the correctness of the accounts of the assessee, or where no method of accounting has been regularly employed by the assessee, the Income-tax Officer shall make the assessment of the total income to the best of his judgement and detemine the tax payable by the assessee or refundable to the assessee on the basis of such assessment. In the case of a registered firm carrying on the business of executing contracts and works, where book results are rejected, the income or profits derived from such contracts

is estimated by the Income-tax Officer as a percentage of net cash received exclusive of the cost of materials received for being used, fixed or incorporated in the works. In such a case, where the net profit is estimated, no further deductions are allowable in computing the taxable income.

A registered firm engaged in the business of construction returned income from contracts amounting to Rs.81.66 lakhs for the assessment year 1987-88. This amount was computed by the assessee after deducting Rs.1.67 lakhs deducted at source from the gross receipts of Rs.83.33 lakhs. This was accepted in the assessments concluded in January 1990. As income-tax payment is not an admissible deduction in computing business income the entire gross receipts of Rs.83.33 lakhs should have been considered for assessment. Incorrect deduction of Rs.1.67 lakhs resulted in short levy of Rs.1.16 lakhs in the hands of assessee firm and partners, including interest for short payment of advance tax.

Ministry of Finance have accepted the observation.

Mistakes in the comptuation of business income

4.15.1 Under the provisions of Income-tax Act, 1961, the liability to tax under the head `Income from house property' arises out of ownership of property. Where there is no ownership, the income arising to an assessee in relation to a property is not liable to be assessed to tax under the head income from house property'. It can be assessed under the head income from other sources' if it cannot be assessed under the head profits and gains of business'. The word business' is wide enough to cover any adventure in the nature of trade or commerce. Any activity embarked upon with the motive of making profit is a business and profit therefrom is liable to be assessed under the head Profits and gains of business or profession'

An assessee trust, entered into an agreement with four co-owners of a partly constructed property under which the trust became a tenant paying annual rent of Rs.1.80 lakhs to

the co-owners. The beneficiaries of the trust were the dependent family members of the co-owners of the property. Under the agreement, the trust could undertake the work of completion of the building and let it. Accordingly the trust completed the unfinished work at a cost of Rs.3.60 lakhs and let the property to the postal department at an annual rent of over Rs.5 lakhs. The co-owenrs had the right to terminate the agreement and demand vacation of the building without any obligation to pay any compensation to the trust for the money spent in completion of the building.

Scrutiny of the assessment records of the assessment years 1986-87 and 1987-88 completed in March 1989 disclosed that the rental income of the trust was assessed under the head Income from house property' instead of under the correct head Profits and gains of business or profession' as the assessee trust was not the owner of the building and the activity carried on was for earning profit which is a business activity. Since the trust carrying on business is liable to be taxed at the maximum rates, the omission to assess the income under the proper head resulted in an aggregate short levy of tax of Rs.3.60 lakhs for the assessment years 1986-87 and 1987-88, including interest leviable for short payment of advance tax.

2. While computing the income of an assessee, the assessing officer normally proceeds with the income as computed by the assessee as the starting point and then makes necessary adjustments by way of additions and deletions, in keeping with the provisions of the Act and Rules to arrive at the total taxable income.

The assessment of a registered firm for the assessment year 1987-88 was completed in March 1990 determining the income at Rs.12.44 lakhs. The profit and loss account of the previous year relevant to the assessment year 1987-88 showed the total turn over at Rs.66.71 lakhs. However, the assessing officer determined the total turnover at Rs.71.54 lakhs under Section 145 of the

Income-tax Act. Thus, the difference of Rs.4.83 lakhs between the turnover determined by the assessing officer and that shown in the profit and loss account was to be added back as income. This was not done. The mistake resulted in underassessment of income of Rs.4.83 lakhs involving short levy of tax of Rs.3.57 lakhsin the hands of the firm (including interest for late filing of the return and short payment of advance tax) and its partners.

The department has accepted the audit observation.

3. Under the provisions of the Income-tax Act, 1961, an assessing officer is empowered to assess or reassess the income escaping assessment, if he has reason to believe that income has escaped assessment and such escapement has occured, among other things, on account of assessee's omission or failure to disclose fully or truly all material facts necessary for assessment for that year. The Act further provides that if any person has concealed the particulars of income or furnished inaccurate particulars of such income, the assessing officer may direct that such person shall pay a penalty as prescribed under the Act in addition to any tax payable by him.

An assessee, a registered firm, during a raid on its business premises and the residential premises of its partners, admitted that the accounts maintained were false, that sales figures had been manipulated and the stock had been undervalued. Subsequent to the raid, the assessee filed revised returns for assessment years 1980-81 to 1982-83 in March 1987, disclosing concealed income. Simultaneously, the original return for assessment year 1984-85 was also filed. Audit scrutiny revealed that the assessments for the assessment year 1984-85 was finalised in March 1988 while the reopened assessment for assessment years 1980-81 to 1982-83 were pending. Scrutiny of the records further revealed that in the accounts for the previous year relevant to assessment year 1984-85, the assessee had debited a sum of

Rs.1.85 lakhs on account of purchases stated to have been omitted to be accounted for in assessment years 1980-81, 1981-82 and 1982-83. Even though the expenditure did not pertain to assessment year 1983-84 and the assessments for the years in respect of which the expenditure was claimed to have been incurred, were still pending finalisation with reference to the material collected during the raid, the assessment for assessment year 1984-85 was completed in March 1988 allowing the deduction. The assessment for assessment years 1980-81, 1981-82 and 1982-83 were completed in December 1988 and February 1989, after duly tallying the value and quantity accounts and after scrutiny of purchase, and sales bills. The detailed scrutiny did not disclose any omission to account for the purchase in those years as claimed by the assessee and claimed in the assessment for assessment year 1984-85. As such, the allowance of Rs.1.85 lakhs in the assessment for the assessment year 1984-85 was not in order and the relevant assessment should have been reopened to withdraw the deduction already allowed. Failure to do so had resulted in under-assessment of income of Rs.1.85 lakhs involving an aggregate short levy of tax of Rs.2.84 lakhs including interest payable for default in payment of advance tax and penalty leviable for furnishing inaccurate particulars of income.

4. Income-tax Act, 1961, provides that any expenditure, not being in the nature of capital expenditure or personal expenses of the assessee, laid out or expended wholly and exclusively for the purpose of the business or profession shall be allowed in computing the income chargeable under the head `Profits and gains of business or profession'.

In the assessment of an assessee registered firm engaged in the business of distribution of drugs, pharmaceuticals and chemicals for the assessment year 1986-87, completed in February 1989 it was noticed that an amount of Rs.7.05 lakhs being interest paid on borrowings from sister concerns and others, was allowed as deduction in the computation

of income. However, interest was not charged on deposits amounting to Rs.29.75 lakhs made by the assessee with two other sister concerns. As the deposits/loans given by the assessee out of the borrowing were diverted for non-business purposes, interest thereon was required to be disallowed from the total interest payments. The assessee had paid interest on the borrowings at various rates from 10 percent to 18 percent. Considering a rate of 15 percent for the amounts diverted for non business purpose, the amount disallowable works out to Rs.4.46 lakhs. Incorrect allowance of interest thus resulted in under assessment of Rs.4.46 lakhs with short levy of tax of Rs. 2.51 lakhs.

Other mistakes in computation of business income

4.16.1 Under the provisions of the Income-tax Act, 1961, any expenditure, not being expenditure of a capital nature or personal expenses of the assessee laid out or expended wholly and exclusively for the purposes of business, is allowable as deduction in computing the income chargeable under the head Profit and gains of business'. All amounts spent upto the point an asset is ready for use should be treated as capital expenditure.

A co-operative society started a new sugar factory during the previous year relevant to the assessment year 1985-86 and the sugar factory started production in February 1985 **i.e.** during the previous year relevant to the assessment year 1986-87. For the assessment year 1985-86 the assessee filed a return showing `Nil' income. The profit and loss account of the relevant previous year indicated a loss of Rs.43.56 lakhs. While completing the assessment for the assessment year 1985-86 in February 1988 after disallowing certain payments, the assessing officer arrived at a loss of Rs.13.70 lakhs which was allowed to be carried forward. As the expenditure of Rs.13.70 lakhs was incurred before commencement of production, it should have been treated as capital expenditure and should not have been allowed to be carried forward treating the same as revenue expenditure. The incorrect treatment of capital expenditure as revenue expenditure

resulted in incorrect carry forward of loss of Rs.13.70 lakhs with consequent potential tax effect of Rs.6.16 lakhs.

2. Under the Income-tax Act, 1961 and the Rules made thereunder, where a feature film is acquired by a film distributor in any previous year and the film is not released for exhibition on a commercial basis at least ninety days before the end of such previous year, the cost of acquisition of the film in so far as it does not exceed the amount realised by the film distributor by exhibiting the film on a commercial basis, or the amount for which the rights of exhibition have been sold or as the case may be, the aggregate of the amounts realised by the film distributor by exhibiting the film and by the sale of the rights of exhibition, shall be allowed as a deduction in computing the profits and gains of such previous year and the balance if any, shall be carried forward to the next following previous year and allowed as a deduction in that year.

The assessment of a Hindu undivided family (specified), engaged in the business of film distribution, for the assessment year 1986-87 was completed in February 1989. The assessee had acquired the rights of a feature film for a sum of Rs.9 lakhs and released it in February 1986. The assessee realised an amount of Rs.6.69 lakhs during the accounting year ending March 1986 relevant to the assessment year 1986-87. The assessee claimed the entire cost of acquisition of Rs.9 lakhs as expenditure and the same was allowed by the assessing officer instead of restricting the same to Rs.6.69 lakhs. This resulted in excess computation of loss of Rs.2.31 lakhs with consequential potential tax effect of Rs.1.08 lakhs.

The department has accepted the audit observation.

Mistake in the computation of income from tea business

4.17 Under the Income-tax Rules, 1962, only 40 percent of the income derived from the sale of tea grown and manufactured by a seller in India is deemed to be income derived from manufacturing and selling operations of the assessee and liable to income-tax, with the remaining 60 percent deemed to relate to the cultivation of tea, income from which is agricultural in nature and hence not liable to income-tax. It has been judicially held[4] (January 1977) that this rule regarding apportionment of income applies only to the income from tea business and not to any other income by way of interest on loans advanced by the concern.

In the previous year relevant to the assessment year 1987-88, a registered firm, apart from its income from tea business, derived income from interest of Rs.3.60 lakhs on loans advanced by it. The interest received was adjusted against interest paid by the firm for its tea business and a net debit entry was made in the relevant profit and loss account. As income from tea business is computed at 40 percent of the composite income derived from agricultural and manufacturing operations involved, only 40 percent of interest income was taxed in place of 100 percent of it taxable as income from other sources. The mistake in the assessment led to under-assessment of income pf Rs.2.16 lakhs (60 percent of Rs.3.60 lakhs) in the hands of the firm and short levy of tax of Rs.1.40 lakhs (including short levy of tax of Rs.88,644 in the hands of two partner sharing profits equally) in assessment year 1987-88.

Incorrect computation of loss

4.18.1 An assessee firm, in the course of its business of export of cashew, at times used to borrow raw cashew from other concerns, and later return it in kind. The value of cashew borrowed was debited to the assessee's profit and loss account, and the value of the cashew returned credited thereto. During the previous year relevant to the assessment year 1983-84, the assessee firm returned, in kind, 5,120 bags of raw

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4. Sookerating Tea Co. (P) Ltd. Vs. C.I.T. Assam (1977) 111-ITR-457-Guwahati

cashew borrowed earlier from a sister concern. It was noticed in audit that the value of the cashew so returned was credited to the profit and loss account, only to the extent of Rs.31.21 lakhs as against the correct amount of Rs.53.65 lakhs creditable. The mistake resulted in excess computation of loss of Rs.22.44 lakhs in the assessment for the assessment year 1983-84, completed in December 1985 and revised in October 1986.

The department has accepted the audit observation.

2. An assessee, a co-operative society the assessment of which was completed in March 1984 was paid interest of Rs.14.52 lakhs in November 1985 by the Income-tax department on the excess payment of advance tax made for the assessment year 1974-75. Since interest of Rs.14.52 lakhs was quantified and allowed in the previous year relevant to the assessment year 1987-88, the same should have been taken as income of the assessee for the assessment year 1987-88 in the assessment completed in March 1989. This income was neither returned by the assessee nor included by the assessing officer in the assessable income for the assessment year 1987-88 resulting in excess computation of loss and carry forward of loss to the extent of Rs.14.52 lakhs with potential revenue effect of Rs.5.77 lakhs.

MISTAKES IN ALLOWANCE OF DEPRECIATION

Mistakes in allowance of depreciation

4.19 Under the Income-tax Act, 1961, in computing the business income of an assessee, a deduction on account of depreciation on plant and machinery or other assets is admissible at the prescribed rates provided these are owned by the assessee and used for the purposes of his business during the relevant previous year.

Depreciation on buildings, plant and machinery is calculated on their cost or written down value, as the case may be, according to the rates prescribed in the Income-tax Rules, 1962. Special rates of depreciation ranging from 15 percent to 100

percent are prescribed for certain specified items of machinery and plant. A general rate of 10 percent (15 percent from the assessment year 1984-85) is prescribed in respect of machinery and plant for which no special rate has been prescribed.

From assessment year 1988-89, the Taxation Laws (Amendment and Miscellaneous Provisions) Act, 1986 has prescribed same percentage of depreciation for assets falling under respective block of assets **i.e.** buildings, machinery, plant or furniture. For plant and machinery the rates of depreciation are 33.1/3 percent and 50 percent and for buildings for low paid employees of industrial undertakings, 20 percent as against the general rate of 5 percent for residential buildings and 10 percent for non-residential buildings. A number of mistakes in the computation and application of the law regarding depreciation were noticed in the assessments of non-companies during the test audit. Some important mistakes are cited.

In the assessment of two assessees, one registered firm, and 1 co-operative society for the assessment years 1983-84 to 1988-89 assessed in 2 different Commissioners' charges between March 1987 and March 1989 due to incorrect application of rates of depreciation allowance and other irregularities in the calculation of depreciation allowance, there was an aggregate excess allowance of depreciation of Rs.23.40 lakhs resulting in short levy of tax of Rs.14.44 lakhs.

S. No.	State/ Commissioners charge/ Name of assessee	Assessment year	Nature of mistake	Under assessment/ Excess allowance (Rs. in lakhs)	Tax effect
1.	Tamil Nadu/ A/ Regd. Firm	1983-84 to 1986-87	Depreciation allowed on a building under construction and not put to use.	17.89 (excess allowance)	12.17

2.	Punjab/ B/ Co-operative society	1988-89	Depreciation on non-factory building, tube-well and roads allowed at 10 percent instead of at the correct rate of 5 percent.	5.51 (excess allow-ance)	2.27 (Poten-tial)

The department has accepted the audit observations in one case.

Ministry of Finance have accepted the audit observation in one case.

Omission to levy capital gains tax

4.20.1 Under the provisions of the Income-tax Act, 1961, any profits or gains arising from the transfer of a capital asset is chargeable to income-tax under the head `capital gains' and is deemed to be the income of the previous year in which the transfer took place. The Act also provides that where a person dies, his legal representative shall be liable to pay any sum which the deceased would have been liable to pay if he had not died, in the like manner and to the same extent as the deceased.

An assessee individual sold a house property for a consideration of Rs.11.40 lakhs (cost of acquisition - Rs.67,000) and the relevant sale deed was registered in December 1984. Audit scrutiny in August 1989 revealed that though necessary clearance certificate for registering the sale of the property was issued, no action was taken by the department to call for the return for assessment year 1985-86 nor did the assesse file any return, to assess the capital gains to tax. The above omission resulted in capital gains of Rs.6.41 lakhs escaping assessment involving non-levy of tax of Rs.3.74 lakhs for assessment year 1985-86.

2. Under the provisions of the Income-tax Act, 1961, where any capital gains arises from the transfer of a long term capital asset and the assessee has within a period of six months, after the date of transfer, invested or deposited the whole of the net consideration in the assets specified in the

Act, the capital gain is exempted in full. Where, only a part of the net consideration is so invested or deposited, so much of the capital gain as bears to the whole of the capital gains the same proportion as the cost of acquisition of new asset bears to the net consideration shall not be charged. The balance of the capital gain shall further be eligible for certain deduction.

An assessee, a registered firm for the assessment year 1988-89 returned long term capital gain of Rs.13.10 lakhs comprising of Rs.5.10 lakhs on sale of land and Rs.8 lakhs relating to goodwill. The assessee claimed a deduction of Rs.7.40 lakhs on the capital assets as per law. In addition, exemption of Rs.5.36 lakhs on account of investment in Industrial Development Bank of India bonds was also claimed. After claiming the deduction and exemption, the assessee offered the balance of Rs.35,310 for taxation. The assessing officer while completing the asessment in February 1989, allowed the deduction as well as exemption as claimed by the assessee. It was, however, noticed during audit that the assessee worked out the deduction of Rs.7.40 lakhs without the first taking into account the exemption of Rs.5.36 lakhs already allowed. Thus, the deduction from the capital gains allowable would correctly work out to Rs.4.69 lakhs as against Rs.7.40 lakhs allowed. The mistake resulted in underassessment of income of Rs.2.71 lakhs involving short levy of tax of Rs.1.64 lakhs in the hands of the firm and its partners.

Ministry of Finance have accepted the audit observation.

3. Profit or gains arising from tranfer of capital asset are chargeeable to income-tax under the head `capital gains'. The capital gain is determined by deducting the cost of acquisition of the asset and of any improvement thereto, from the value of the consideration received or accuring on the transfer. Where the capital asset becomes the property of the assessee before 1 January 1964, at the option of the assessee the fair

market value as on that date is taken as the cost of acquisition . Besides, any expenditure incurred wholly and exclusively in connection with the transfer of the capital asset is also deductible from the consideration received for arriving at the net capital gains to be brought to tax. the Act further provides for exemption of the capital gains from tax on investment of the sale consideration in the prescribed manner.

The assessment of an individual for the assessment year 1982-83 was completed in March 1983 computing the total income of Rs.47,470 which included a capital gains amount of Rs.22,970. While arriving at the value of the capital gain, from the gross sale proceeds of Rs.7.10 lakhs, deductions were allowed comprising Rs.1.78 lakhs towards cost of acquisition as on 1 January 1964, Rs.4.19 lakhs towards other expenses in conection with the transfer of the asset and certain improvements thereon at Rs.77,870 towards investment made in the prescribed securities under Section 54 E of the Act. It was pointed out in audit that the cost of acquisition as on 1 January 1964 should be Rs.1.10 lakhs and that deductions towards other expenses were not allowable as they were neither for improvement of the asset nor were they in connection with the transfer of the asset and that the deduction towards investment in the prescribed securities also was not allowable as it was not made out of the sale consideration of the asset. The points were examined by the department (March 1985) and the appellate authority (January 1989) and finally the assessment was revised (February 1989) with a taxable income of Rs.2.82 lakhs resulting in an additional demand of Rs.1.60 lakhs.

Ministry of Finance have accepted the audit observation.

4. Under the provisions of the Income-tax Act, 1961, where the whole of the net consideration received from the transfer of a capital asset, not being a short term capital asset, is invested in any of the `specified assets' within a specified period after the

date of transfer, the whole of the capital gains arising out of transfer shall not be charged to tax. The Act also provides that if the cost of the `specified assets' **i.e.** new asset, is less than the net consideration in respect of the original asset, so much of the capital gain as bears to the whole of the capital gain the same proportion as the cost of acqusition of the new asset bears to the net consideration received in respect of the original asset, shall not be charged to tax. Further, under the Act, where the gross total income of an assessee, not being a company includes any income chargeable under the head `capital gains' relating to capital asset, there shall be allowed in computing the total income of the assessee, a deduction from such income at the rates specified in Twelth Schedule.

In the previous year relevant to the assessment year 1986-87 an individual assessee earned a long-term capital gains of Rs.22.47 lakhs by sale of shares of a company. Out of the above amount the assesse invested Rs.11.12 lakhs towards construction of a new residential house and Rs.7.05 lakhs towards purchase of units from Unit Trust of India and claimed exemption for the whole amount of the capital gain of Rs.22.47 lakhs which was allowed by the assessing officer in the assessment completed in October 1987. Under the provisions of the Act, however, the assessee was entitled to a proportionate exemption at Rs.16.61 lakhs on the ratio of which the cost of new assets bears to the net consideration received. The irregular grant of exemption resulted in allowance of exemption in excess by Rs.5.86 lakhs after allowing deductions admissible under the Act. There occurred an underassessment of income by Rs.3.48 lakhs involving undercharge of Rs.1.78 lakhs including interest of Rs.0.04 lakh for belated filing of return.

Ministry of Finance have accepted the audit observation.

Income not assessed - lack of corelation with the records of other taxes

4.21 The Central Board of Direct Taxes in their instructions in November 1974 directed that proper liasion should be maintained with sales-tax authorities so that various matters arising from the proceedings under the Sales-tax Act which have bearing on the income tax assessment are taken due note of by the income tax authorities in the relevant assessment proceedings.

The need for a proper co-ordination among the assessment records pertaining to direct taxes to ensure an overall improvement in the administration of these taxes has been repeatedly emphasised by the Public Accounts Committee. Mention in this respect may be made of paragraph 4.12 and 4.13 of 186th Report (Fifth Lok Sabha) and paragraph 1.19 of the 61st Report (Sixth Lok Sabha) of the Public Accounts committee. The Central Board of Direct Taxes have also issued instructions from time to time, the latest being on 11 April 1979 for carrying out such corelation. Despite these instructions, instances of under charge of tax resulting from omission to utilise information already available in the assessment records of other direct taxes continue to be noticed.

A registered firm dealing in oil cakes showed a net sales turnover of Rs.189.20 lakhs in its accounts for the period ending 31 March 1988 which included Rs.116.22 lakhs pertaining to sales and commission sales within the State. This was accepted by the assessing officer in the assessment for the assessment year 1988-89 completed in November 1989. Audit scrutiny in January 1991 of the sales tax authorities had determined the net sales turnover including commission sales within the state at Rs.119.92 lakhs. Omission to adopt the sales turnover of the assessee firm as determined by the sales-tax authorities in the income-tax assessment resulted in the underassessment of income amounting to Rs.3.70 lakhs involving short levy of tax aggregating to Rs.2.26 lakhs in the hands of the firm and partners (including Rs.22,158 being interest for short payment of advance tax in the hands of the firm).

Mistakes in the assessment of firms and partners

4.22 Under the provisions of the Income-tax Act 1961, if the assessment of the firm has not been completed the share income from the firm is included in the assessments of the partners on provisional basis and revised later to include the final sahre income on completion of the assessment of the firm. For this purpose, the Income-tax Officer is required under the instruction issued by the Central Board of Direct Taxes in March, 1973 to maintain a `Register of cases of provisional share income' so that these cases are not omitted to be rectified. No revision of asssessment of partner can, however, be made under the Act, after the expiry of four years from the end of the financial year in which the final order was passed in the case of the firm.

The Central Board of Direct Taxes issued instructions in November 1981 that where the firm and its partners are assessed in different wards, the income-tax Officer assessing the firm should communicate the share income of each partner to the Income-tax Officer having jurisdiction to assess such partners immediately after completion of the assessment of the firm and should insist for its acknowledgement by the other Income-tax Officer. The latter was also required to revise the assessments of the partners within three months of receipt of intimation of share income. These instructions were issued to ensure that the correct share incomes are assessed in the hands of the partners promptly and correct tax due to the Government is assessed and demand raised without loss of time.

Pursuant to the recommendations of Public Accounts Committee made in 85th Report (Seventh Lok Sabha-1981-82), the department issued fresh instructions in April 1983 for proper maintenance of provisional share income registers and adequate checking of the registers by Range Inspecting Assistant Commissioners and departmental audit parties. Reiterating the earlier instructions the Board in their instructions issued in October 1984 also stated that there should be co-ordination between the assessing officers

assessing the firm and the partners in the matter of ascertaining correct share income of partners and taking rectificatory action based on it. The Board issued clarificatory orders in February 1988 specifying that even in the assessment of partners completed in summary manner the remedial measures to rectify the mistakes could be taken.

Inspite of these instructions cases of failure to revise the share income of the partners consequent upon the completion of the assessments of the firm continue.

During the test check in 6 Commissioner's charges for the assessment years 1975-76 to 1987-88 in the case of six registered firms due to omission to revise the assessment of the partners of the firm consequent upon the assessment of the firms there was a short levy of tax of Rs.75.78 lakhs.

The particulars of the cases are given below:

S. No.	State/ Commissioners charge	Assessment years	Partner's share income adopted	Share income assessed (Rupees	Under assess-ment in	Tax effect lakhs)
1.	Karnataka/ A	1984-85 1985-86	--	23.85	23.85	37.69 (includ-ing inter-est of Rs.24.56 lakhs)
2.	Delhi/ B	1985-86	7.56	46.62	39.06	23.95
3.	Tamil Nadu/ C	1978-79 to 1982-83	12.47	18.85	6.38	4.26
4.	Tamil Nadu/ D	1984-85	1.16	7.37	6.21	4.19
5.	Punjab/ E	1975-76 to 1977-78	5.65	12.00	6.35	3.03
6.	Punjab/ F	1987-88	--	6.57	6.57	2.66

The department has accepted the audit observations in one case.

Ministry of Finance have accepted the audit observation in four cases.

Income not assessed

4.23.1 Under the provisions of Income-tax Act, 1961, where any sum is credited in the books of an assessee for any previous year and where the assessee offers no explanation about the nature and source thereof or the explanation offered by him in the opinion of the assessing officer is not satisfactory, the sum so credited may be charged to income-tax as the income of the assessee of that previous year.

During the previous year relevant to assessment year 1984-85 an assessee along with seven individuals jointly won first prize of Rs.1 crore of a State lottery out of which 4 assessees credited Rs.11.25 lakhs each in their accounts being net amount of 1/8th share of prize money but did not offer the receipts for tax stating that the entire amount had been taxed in others hand in another circle. While completing assessments of these 4 assessees in March 1987 the Inspecting Assistant Commissioner (Assessment) accepted the assessee's statement and brought the amount to tax as a protective measure subject to verification. The assessees deposition was not, however, verified till November 1988 and no further action was taken to make regular assessment to bring the entire amount to tax. If joint purchase of lottery ticket as claimed by the assessee is accepted, assessment was to be made in the status of association of person on income of Rs.44.98 lakhs after deducting Rs.10 lakhs as sellers commission and Rs.45.03 lakhs as allowable relief from the prize money of Rs.1 crore. Omission to do so resulted in escapement of income by Rs.44.98 lakhs leading to non-levy of tax of Rs.30.13 lakhs.

The department has accepted the audit observation.

2. Under the provisions of the Income-tax Act, 1961, a return of income which showed the total income below the maximum amount which is not chargeable to tax shall be deemed never to have been furnished. The provisions do not apply where, **inter alia,** the return of loss has been furnished in accordance with the provisions of the Act.

In the case of a co-operative society, the assessing officer, in his orders passed in December 1989 treated the returns for the assessment years 1987-88 and 1988-89, furnished by the assessee as deemed not to have been furnished, being the returns for income below the taxable limit and thus made no assessments for these years. The return for the assessment year 1987-88 was furnished by the assessee for `nil' taxable income, after claiming deduction under Chapter VIA of the Act in respect of the income of the co-operative societies, equal to the profit of Rs.4.63 lakhs, whereas the assessee did not satisfy the conditions laid down in the Act for admissibility of such deduction. The income of Rs.4.63 lakhs assessable to tax escaped assessment resulting in non-levy of tax of Rs.1.85 lakhs. In respect of the assessment year 1988-89 the assessee furnished return for `nil' taxable income, after setting off of carried forward loss for the assessment year 1984-85 to the extent of profit of Rs.8.12 lakhs and claiming carry forward of unabsorbed losses of Rs.18.09 lakhs for the assessment year 1984-85 and 1985-86. These losses were, however, not allowed to be carried forward in the assessments made in March 1990 and February 1988 respectively, the returns of losses being furnished late. The income of Rs.8.12 lakhs assessable to tax, thus , escaped assessment. Further, the assessee had claimed deduction in respect of the provision made in the accounts for lump sum depreciation of Rs.3 lakhs without furnishing details of assets. The claim being in respect of contingent liability was not admissible and was includible in the total income of the assessee.

These mistakes led to the total income for the assessment years 1987-88 and 1988-89 aggregating to Rs.15.75 lakhs escaping assessment involving non-levy of tax of Rs.6.52 lakhs.

3. The total income of a person should include all income that accrues or arises to him in India, during the previous year. Where an assessee maintains accounts according to mercantile system, the income computed for assessment should be the income actually earned though not realised, bringing into credit what is due immediately it becomes legally due, even though it is not actually received during the year.

During the previous year relevant to the assessment year 1985-86, an unregistered firm following mercantile system of accounting had an outstanding loan balance of Rs.29.35 lakhs due from a company in which the partners of the firm had substantial interest. As the firm provided the loan to the company when it itself had bank overdraft carrying interest at the rate of 18 percent per annum, the assessing officer assessed accrued interest on the outstanding loan balance of the previous year ended March 1984 at 18 percent in the assessment year 1984-85 as required under the provisions of the Act. However, in the assessment made in October 1988 for the assessment year 1985-86 the accrued interest on loan of Rs.29.35 lakhs which worked out to Rs.5.28 lakhs was not considered as accrued interest income. The omission led to underassessment of income of Rs.5.28 lakhs and consequent undercharge of tax of Rs.5.19 lakhs including interest of Rs.0.20 lakh for belated submission of return and Rs.1.72 lakhs for short payment of advance tax in assessment year 1985-86.

The department has accepted the audit observation.

4. Under the provisions of the Income-tax Act 1961, the total income of any previous year of a person, inter alia, includes all income from whatever source derived which is received or is deemed to be received in India

in such year or accrues or arises or is deemed to accrue or arise to him in India during such year. On the basis of judicial decision[5] (January 1982), the Central Board of Direct Taxes issued instructions in February 1986 stating that the cash compensatory support given to exporters is taxable as trading receipts. The Finance Act 1990 has also introduced an amendment to the Income-tax Act with retrospective effect from the assessment year 1967-68 that export incentives given to exporters by way of cash compensatory support or any other subsidy received by them for export will be included in the definition of income and taxed under the head `Profits and gains of business or profession'.

The intimation in respect of a registered firm for the assessment year 1989-90 was sent in February 1990 accepting the total income of Rs.5.13 lakhs. Audit scrutiny in November 1990 revealed that during the relevant previous year the firm had received cash assistance of Rs.16.95 lakhs from the Government of India against exports which was assessable as income as per the amended provisions of the Act, but this was not included in the taxable income. The omission resulted in escapement of income of Rs.3.73 lakhs (after allowing corresponding deduction for export turnover) with a consequential short levy of tax of Rs.2.74 lakhs including interest for default in payment and for deferment of advance tax.

The department has accepted the audit observation.

5. An assessee individual invested a sum of Rs.18 lakhs derived by her through unexplained sources according to her own admission in January 1990, towards construction of a house property during the previous years relevant to the assessment years 1983-84 to 1987-88. The assessing officer proposed to assess the same at Rs.2 lakhs each for the assessment years 1983-84

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5. Jeewan Lal (1929) Ltd. Vs. C.I.T. Central Circle-II, Calcutta (142-ITR-448)

to 1986-87 and at Rs.10 lakhs for the assessment year 1987-88 as income by way of unexplained investments. Audit scrutiny in May 1990 revealed that though this aspect was considered in the assessment for the assessment years 1984-85,1986-87 and 1987-88, the assessment for the assessment years 1983-84 and 1985-86 were not reopened to assess the income from unexplained sources. The omission resulted in under-assessment of income of Rs.2 lakhs for each year involving an aggregate short levy of tax of Rs.2.44 lakhs.

The department has accepted the audit observation.

6. The Public Accounts Committee has emphasised the need for proper correlation among the assessment records pertaining to direct taxes to ensure an overall improvement in the administration of these taxes. Mention in this respect may be made of paragraph 4.12 and 4.13 of 186th Report (Fifth Lok Sabha) and paragraph 1.19 of the 61st Report (Sixth Lok Sabha) of the Public Accounts Committee. The Central Board of Direct Taxes have also issued instructions from time to time, the latest being on 11 April 1979 for establishing such correlation. Despite these instructions, instances of undercharge of tax resulting from omission to utilise information already available in the assessment records of other direct taxes continue to be noticed.

An individual who had never been assessed before, filed his wealth-tax return for the assessment years 1979-80 to 1986-87 on 31 March 1987 under the Voluntary Disclosure Scheme. The wealth-tax assessments for the assessment years 1979-80 to 1985-86 were made under summary manner in June 1987 and that for the assessment year 1986-87 was also made under summary manner in August 1987 as per return. It, however, transpired from the details of the wealth-tax returns for the assessment years 1984-85, 1985-86 and 1986-87 that the individual had progressive investments in a new house property shown at Rs.1 lakh, Rs.2 lakhs and Rs.7 lakhs

respectively indicating new investments of Rs.1 lakh in assessment year 1984-85, Rs.1 lakh in assessment year 1985-86 and Rs.5 lakhs in assessment year 1986-87 from a source not disclosed to the Income-tax Department. Other assets of the individual remained almost the same in all the assessment years. The individual did not file any return of income for these years under the Voluntary Disclosure Scheme or otherwise. The department also did not initiate any income-tax assessment proceedings to assess the income disclosed in the wealth-tax return. This led to escapement of assessable income from undisclosed sources aggregating to Rs.7 lakhs and resultant non-levy of income-tax of Rs.3.13 lakhs in assessment years 1984-85 to 1986-87. There was also non-levy of penalty for failure to furnish returns aggregating to Rs.1.69 lakhs upto the end of the completed month preceding the date of audit (June 1988).

The department has accepted the audit observation.

Incorrect set off/carry forward of losses.

4.24 Under the Income-tax Act, 1961, no loss is allowed to be carried forward for set off against the profits of future years unless such loss has been determined in pursuance of a return filed by the assessee.

The income of a co-operative society for the assessment year 1987-88 was computed at Rs.1333.43 lakhs in the assessment made in January 1990 and the carried forward losses of equal amount for the assessment years 1979-80 to 1984-85 were allowed to be set off against the assessed income. Further losses of Rs.773.43 lakhs pertaining to the assessment years 1984-85 to 1986-87 were allowed to be carried forward for set off against the profits of future years. However, the `best judgement' assessment for the assessment year 1981-82 was made in March 1989 for `nil' income after considering all carried forward losses. Thus set off of losses for the assessment year 1979-80 to 1981-82 aggregating to Rs.452.18 lakhs (included in the loss of Rs.1333.43 lakhs allowed to be set off) was erroneous.

Loss of the assessment year 1986-87 determined in the assessment made in March 1989 at Rs.117.78 lakhs was reduced to Rs.108.18 lakhs in the revision made in March 1990. However, no revision of assessment for the assessment year 1987-88 was made. Correspondingly to reduce such loss included in the losses of Rs.773.43 lakhs for the assessment years 1984-85 to 1986-87 allowed to be carried forward for set off, which resulted in excess carry forward of loss for set off to the extent of Rs.9.59 lakhs. Total excess carry forward of loss for set off was Rs.461.77 lakhs which resulted in potential short levy of tax of Rs.184.71 lakhs.

Ministry of Finance have accepted the audit observation.

Mistake in giving effect to appellate order

4.25 In the assessment of a Trust for the assessment year 1985-86, concluded in March 1988 deduction of Rs.75.33 lakhs toward payment of sales tax which was disallowed in the assessment for the assessment year 1984-85 was allowed. However, a sum of Rs.6.74 lakhs being interest payable on kist payment relating to the assessment year 1983-84 was disallowed in the assessment. Thus, a net deduction of Rs.68.59 lakhs was made in the assessment for assessment year 1985-86. On an appeal filed by the assessee, disallowance of Rs.75.33 lakhs made in the assessment for the assessment year 1984-85 was deleted and consequent rectifications in the assessment for the assessment year 1985-86 were made in March 1989 withdrawing the deduction allowed. In rectificatory order, instead of withdrawing the deduction of Rs.75.33 lakhs only a sum of Rs.68.59 lakhs was considered. Further the appeal filed by the assessee against the disallowance of Rs.6.74 lakhs made in the assessment for the assessment year 1985-86, was also decided in favour of the assessee. While giving effect to the appellate order in August 1989 relief for Rs.6.74 lakhs was again allowed, overlooking the fact that relief to this extent was already incorrectly given in the rectification order passed in March 1989. This mistake resulted in underassessment of income by Rs.6.74 lakhs for assessment year

1985-86 with consequent short levy aggregating Rs.5.32 lakhs (including interest for belated filing of return and short payment of advance tax) for the assessment years 1985-86 to 1987-88.

Ministry of Finance have accepted the audit observation.

2. While revising orders for the assessment year 1980-81 in March 1989 to give appeal effect, an unregistered firm was rightly levied tax of Rs.34.69 lakhs including interest of Rs.7.19 lakhs and Rs.14.29 lakhs for belated submission of return and for short payment of advance tax respectively. But in the demand notice for tax issued on 20 March 1989, although all other demands were correctly made, interest for delayed submission of return of income was computed at Rs.5.54 lakhs instead of Rs.7.19 lakhs. This led to short demand of Rs.1.65 lakhs.

3. In the assessment of a registered firm engaged in the business of poultry farming for the assessment year 1980-81 the assessing officer, while giving appeal effect in December 1989, redetermined the income from business at Rs.31.06 lakhs which was originally assessed at Rs.36.08 lakhs but omitted to withdraw excess deduction of Rs.1.71 lakhs involving short levy of tax of Rs.1.58 lakhs (Rs.73,645 in the hands of firm and Rs.84,281 in the hands of partners).

The department has accepted the audit observation.

IRREGULAR EXEMPTIONS AND EXCESS RELIEFS

Incorrect exemption in the case of co-operative society

4.26 Under the provisions of the Income-tax Act, 1961, the income of a co-operative society attributable to certain specified activities is wholly exempt. Income derived from activities other than the specified ones is also exempt to some specified extent subject to fulfilment of certain conditions. But in the case of a co-operative society other than a housing society or an urban consumers society any income from house property is exempt only if the gross total

income does not exceed rupees twenty thousand.

In the case of a co-operative society engaged in marketing of agricultural produce as also purchase/supply of agricultural implements, seeds etc., in the computation of income for the assessment year 1984-85, assessment for which was completed in December 1987 and revised in November 1988, the amount of Rs.14.53 lakhs being income from property, was considered as exempt. But as the assessee was not a housing society nor an urban consumers society and its gross income having exceeded Rs.20,000, the income from property did not qualify for exemption. The erroneous exemption allowed by the department resulted in underassessment of income by Rs.14.53 lakhs with consequent undercharge of tax of Rs.6.49 lakhs for the assessment year 1984-85.

The department has accepted the audit observation.

Mistake in allowing deductions under Chapter VI A

4.27 Under the provisions of Chapter VIA of the Income-tax Act 1961, certain deductions are admissible from the gross total income of an assessee in arriving at the net income chargeable to tax. The over-riding condition is that the total deduction should not exceed the gross total income of the assessee. `Gross total income' has been defined in the Act as the total income computed in accordance with the provisions of the Act before making the deductions under Chapter VIA.

(i) In the assessment of a registered firm for the assessment year 1981-82 as revised in May 1988 the income was determined at Rs.17.21 lakhs out of which deductions of Rs.5.46 lakhs in respect of dividends attributable to new industrial undertaking and Rs.25,000 in respect of donations made by the firm was allowed. The balance income of Rs.11.50 lakhs was adjusted against the carried forward unabsorbed depreciation of Rs.42.26 lakhs relating to the assessment year 1980-81 and the taxable income was determined as `Nil'. Under the provisions of

the Act, the `gross total income' is arrived at after adjusting the carried forward unabsorbed depreciation. Therefore, if the entire income of Rs.17.21 lakhs was adjusted first against the carried forward unabsorbed depreciation of Rs.42.26 lakhs relating to assessment year 1980-81 there would not be any positive income to allow deductions under Chapter VIA. The incorrect deductions, therefore, led to excess carry over of unabsorbed depreciation by Rs.5.71 lakhs resulting in short levy of tax of Rs.4.34 lakhs in the hands of the firm and partners for assessment year 1985-86 in the assessment of which the carried forward unabsorbed depreciation of assessment year 1980-81 was adjusted in full and a positive income determined.

Ministry of Finance have accepted the audit observation.

(ii) The assessment of a registered firm for the assessment year 1985-86 was completed in March 1988 on a total income of Rs.8.60 lakhs after allowing incentive deduction of Rs.7.47 lakhs for export turnover from the gross total income of Rs.15.53 lakhs. Subsequently, on 9 January 1989, the Commissioner of Income-tax (Appeal) allowed relief of Rs.15.11 lakhs to the firm from business income on various counts. The assessment for the assessment year 1985-86 was accordingly revised in May 1989 and the firm's income was re-computed at a loss of Rs.7.05 lakhs after deducting Rs.15.11 lakhs from the original assessed income of Rs.8.06 lakhs. Since deduction under chapter VIA was required to be limited to the gross total income which worked out to Rs.0.42 lakhs (Rs.15.53 lakhs minus Rs.15.11 lakhs) only, the mistake resulted in irregular deduction of Rs.7.05 lakhs resulting in excess allocation of loss in the hands of two partners to that extent involving a potential tax effect of Rs.3.92 lakhs.

Ministry of Finance have accepted the audit observation.

4.28 Under the Income-tax Act, 1961, any person responsible for paying any sum to any resident for carrying out any work in pursuance of a contract shall at the time of payment thereof deduct an amount equal to two percent of such sum as income-tax and shall pay the sum so deducted to the credit of the Central Government. Such payment shall be treated as payment of tax on behalf of the person from whose income the deduction was made and credit shall be given to him for the amount so deducted on the production of a certificate for the tax deducted. The Act also provides that if the amount of tax paid for any assessment year exceeds the amount for which he is properly chargeable under the Act for that year, the excess tax so paid is refunded after the completion of assessment.

In the case of a registered firm for the assessment year 1988-89, tax of Rs.3.99 lakhs was determined as chargeable. After giving credit for the tax deducted at source for Rs.13.66 lakhs, a refund of Rs.9.67 lakhs became due to the assessee. A refund order for Rs.10.50 lakhs including a refund of Rs.82,887 due for the assessment year 1985-86 was issued in March 1989. Scrutiny of the certificates of tax deducted at source, however, indicated that the amount of a certificate issued by a Corporation was incorrectly taken as Rs.1.41 lakhs against actual amount of Rs.214 while the amount of Rs.8,501 for another certificate was taken as Rs.850. These mistakes alongwith another mistake of allowing credit for another certificate for Rs.888 twice led to excess/irregular refund of Rs.1.34 lakhs.

Ministry of Finance have accepted the audit observation.

NON LEVY OR INCORRECT LEVY OF INTEREST

4.29.1 Under the provisions of the Income-tax Act, 1961, where the return of income is not furnished and the assessing officer makes the assessment of the total income to the best of his judgement, the assessee is liable to pay simple interest at fifteen percent (twelve percent prior to 1 October 1984) from

the day immediately following the specified date of furnishing the return to the date of completion of assessment on the amount of tax payable on the total income as determined on regular assessment as reduced by the advance tax, if any, paid and any tax deducted at source. Further, where the return for an assessment year is furnished after the specified due date the assessee shall be liable to pay simple interest, at twelve percent (fifteen percent from 1 October 1984) per annum from the day immediately following the specified date to the date of furnishing of the return. The Act also provides that where on making regular assessment the Income-tax Officer finds that any person who is required to send estimate of advance tax payable by him in the manner laid down in the Act, has not sent such an estimate, simple interest at the rate of twelve percent per annum fifteen percent from 1 October 1984) from the first day of April next following the financial year upto the date of regular assessment is payable by the assessee. The Central Board of Direct Taxes clarified in December 1974 that for this purpose the actual date of filing the return should be included in computing the period for which interest is leviable.

(i) In the best judgement assessment of an individual for assessment years 1982-83, 1983-84 and 1984-85 completed in March 1989, the assessing officer omitted to adopt the correct rate of 15 percent from 1 October 1984 in computing the interest for delay in furnishing the return and non-submission of the statement of advance tax. The mistake resulted in short levy of interest of Rs.26.29 lakhs.

Ministry of Finance have accepted the audit observation.

(ii) The assessments of an individual for the previous years relevant to the assessment years 1983-84 to 1987-88 were completed ex-parte in February 1990 on total income of Rs.12 lakhs for each of the above assessment years. Assessment records revealed that the assessee did not file any return of income

for any of the above noted assessment years. The assessee was, thus, liable to pay penal interest for non-filing of returns of income from the specified date to the date of regular assessments. It was, however, noticed in audit that the department omitted to levy any such interest. Failure to do so, therefore, resulted in non-levy of interest of Rs.23.76 lakhs for the assessment years 1983-84 to 1987-88.

Ministry of Finance have accepted the audit observation.

(iii) In the assessment of a partnership firm for the assessment year 1984=85, completed in March 1990, an amount of Rs.3.05 lakhs was levied towards interest for delay in filing the return of income, as against Rs.8.72 lakhs correctly leviable. The mistake resulted in short levy of interest of Rs.5.67 lakhs.

Ministry of Finance have accepted the audit observation in principle.

(iv) Two individuals did not furnish returns of income in response to notices issued to them in respect of income escaping assessment. For the assessment year 1979-80 in one case and the assessment years 1984-85 to 1986-87 in the other, they also omitted to furnish estimates of advance tax payable by them and paid no advance tax. In the assessments completed in March 1990, interest leviable for non furnishing of returns and for non payment of advance tax was not computed correctly which resulted in undercharge of interest aggregating to Rs.99,200 for non-furnishing of returns and Rs.1.66 lakhs for non payment of advance tax. Besides, in the case of a third individual neither estimates for advance tax payable in respect of the assessment year 1985-86 were furnished nor was advance tax paid by him. In the assessment completed in March 1990, interest leviable was not computed correctly which resulted in undercharge of interest of Rs.1.39 lakhs. Thus, there was short computation of interest of Rs.4.04 lakhs in the three cases.

The department has accepted the audit observation in two cases.

2. Prior to the assessment year 1985-86, in the case of a registered firm for delay in submission of return of income, interest was to be calculated on the amount of tax which would have been payable had the firm been assessed to tax as an unregistered firm.

While completing the assessment of two registered firms for the assessment year 1984-85 in March 1986 and March 1990, the assessing officer levied interest of Rs.1.19 lakhs and Rs.92,610 respectively for delay in submission of return on the basis of tax payable by registered firms instead of calculating it on the basis of tax payable by the unregistered firms. The mistake resulted in short levy of interest of Rs.3.38 lakhs in the two cases.

The department has accepted the audit observation.

Non-levy of interest for delay in payment of demand of tax

4.30.1 Under the Income-tax Act, 1961, any demand for tax should be paid by an assessee within thirty five days of service of notice of the relevant demand and failure to do so would attract simple interest at 12 percent (15 percent from 1 October 1984) per annum from the date of default. In November 1974, the Central Board of Direct Taxes issued instructions that interest for belated payment of tax should be calculated and charged within a week of the date of final payment of the tax demands. In April 1982, the Board issued instructions clarifying that interest is to be calculated with reference to the date of service of original demand notice on tax finally determined in cases of assessments set aside or varied by the appellate authority and the fact that during the intervening period, there was no tax payable by the assessee under any operative order would make no difference. The rules also require that interest has to be calculated and levied on the amount of demand pending at the end of each financial year.

(i) In the case of a registered firm, the assessment for the assessment year 1983-84 was completed in March 1986 and the notice of demand for Rs.7.49 lakhs was served on the assessee in March 1986 which became due for payment in May 1986. The assessee made payment on different dates between April 1986 and March 1988. No demand for interest was raised on the firm as required under the Act and the instructions issued by the Central Board of Direct Taxes. The omission resulted in non-levy and non-recovery of interest amounting to Rs.1.69 lakhs.

Ministry of Finance have accepted the audit observation.

(ii) The assessments of one registered firm and one individual for the assessment year 1984-85 were completed in March 1987 and notices of demands were served on the assessees in May 1987 and March 1987 respectively. Subsequently on revision of original assessments to give effect to appellate orders assessments were completed in January 1989 and December 1988 and revised tax demands were paid in March 1988 and January 1990 respectively and demands against the assessee were also vacated. Though the tax demand were paid beyond the permissible period of 35 days from the date of serving of demand notice, no action was initiated to levy interest for late payment of tax demand. The omission led to non-levy of interest of Rs.1.55 lakhs in aggregate.

Ministry of Finance have accepted the audit observation.

2. Further, where the case of an assessee in default is referred by means of a recovery certificate to the Tax Recovery Officer for recovery of tax dues, the officer shall levy and collect interest on the arrears of tax from the date next to the date of certificate to the date of realisation.

In the assessment of an assessee, an individual, for the assessment year 1979-80, the notice of demand of tax of Rs.4.63 lakhs which was later reduced to Rs.2.83 lakhs in

modification order in September 1988 as a result of appellate order, was served in September 1982, and a reference to the Tax Recovery Officer was made in March 1984. The case was closed without levy of interest for failure to pay the demand within the time prescribed under the Act. Taking into account the various remittances made by the assessee during the period from March 1986 to December 1987, the interest leviable worked out to Rs.1.64 lakhs.

Ministry of Finance have accepted the audit observation.

Short/Non levy of interest fo short payment of advance tax

4.31 Under the provisions of Income-tax Act, 1961, where an assessee has paid advance tax on the basis of his own estimates and the advance tax so paid falls short of 75 percent of tax determined on regular assessment, simple interest at the rate of fifteen percent per annum is payable by the assessee on the amount by which the advance tax as paid falls short of the assessed tax from the first day of the next financial year to the date of regular assessment. If as a result of re-assessment, the amount of assessed tax is increased, the interest shall also be increased accordingly.

In the case of an assessee, an individual, it was noticed that the assessed tax was considerably increased on account of revision of assessment for the assessment years 1986-87 and 1987-88 which attracted the provisions of interest aplicable to payment of advance tax. No interest was, however, levied, and this resulted in non-levy of interest amounting to Rs.1.94 lakhs.

Irregular payment of interest on delayed refund

4.32 Under the provisions of the Income-tax Act, 1961, if the assessing officer does not grant a refund, in a case where the total income does not consist solely of income from interest on securities or dividends, within three months from the end of the month in which the total income is determined under this Act, and in any other case within three months from the end of the month in which the claim for refund is made under the Act, the Central Government shall pay the assessee

simple interest at twelve percent (fifteen percent from 1 October 1984) per annum on the amount directed to be refunded from the date immediately following the expiry of the period of three months aforesaid to the date of the order granting the refund. The Central Board of Direct Taxes issued instructions in March 1971 that in the case of refund arising as a result of any order in appeal, revision or any other proceedings, the three months period will be reckoned from the end of the month in which the order in appeal, revision or other proceedings is passed.

The assessments for the assessment years 1982-83 to 1986-87 of a registered firm, working as sub-contractor, were originally completed between March 1984 and March 1988 and were subsequently revised in January 1989. In the original assessments, the assessee furnished certificates of tax deducted at source issued by the contractor at the rate of one percent of the gross amount of the bill and accordingly credit for the same was allowed in the assessments. As, however, two percent of the gross amount of the bill was deducted by the contractee from the bills preferred by the assessee through the contractor, the assessee was subsequently issued certificates of tax deducted at source at the rate of two percent of the gross amount of the bill. On the basis of the said tax deduction certificates, the assessee claimed refund on 14 December 1988. The assessee was entitled to a refund of Rs.3.13 lakhs accordingly. The department, however, revised the assessments on 18 January 1989, determining a sum of Rs.5.14 lakhs as refundable to the assessee, which included a sum of Rs.2.01 lakhs as interest for belated refund. The refund order was also issued on 25 January 1989. As the refund was granted within a period of one month from the date of the revisional order as a result of which the refund arose, the assessee was not entitled to any interest for belated refund. Incorrect payment of interest, therefore, resulted in excess and erroneous refund of Rs.2.01 lakhs for the assessment years 1982-83 to 1986-87

The department has accepted the audit observation.

Omission to levy penalty

4.33 The Income-tax Act, 1961 as amended from the assessment year 1985-86 and onwards has made it obligatory for every assessee whose total sales/turnover or gross receipts in business exceeds forty lakh rupees in any previous year to get his accounts audited by an authorised accountant before the due date for submission of the return of income and obtain before that date the report of such audit in the prescribed form. The due date for filing the return of business income has been prescribed as 30 June or 31 July of the assessment year depending on whether the accounts of the assessee are closed for the period preceding February or March. Failure to get the accounts audited and to obtain the audit report within the due date renders the assessee liable to a penalty equal to one-half percent of the total sales/turnover or gross receipt or rupees one lakh whichever is less. However, for the assessment year 1985-86 instructions were issued by the Central Board of Direct Taxes in June 1985 that penalty would not be attracted provided the prescribed audit report was obtained upto 30 September 1985 and self assessment tax was paid within the normal period prescribed under the Act for filing the return of income. The Board had also issued general instructions in September 1975 that where the assessing officer decides not to levy penalty in any case, he should record the reasons for not doing so.

(i) In the case of 13 assessees, 10 registered firms and 3 individuals, the returns of income-tax for the assessment years 1985-86 to 1988-89 were filed alongwith the prescribed audit reports of chartered accountants after the expiry of due dates specified for each of the assessment years, as the due date for obtaining the audit reports expired on 30 September 1985 for the assessment year 1985-86 and 31 July 1986, 31 July 1987 and 31 July 1988 for the assessment years 1986-87, 1987-88 and 1988-89 respectively. Though the assessees were liable for penalty for the delay in the

assessments completed between February 1987 and March 1990 the assessing officer did not initiate any penalty proceedings or keep a note of the reaons for not initiating the proceedings. At the rate of one-half percent of the turnover or rupees one lakh whichever is lower, the penalty leviable in these cases aggregated to Rs.14.25 lakhs for the four assessment years.

The department has accepted the audit observations in 12 cases.

Ministry of Finance have accepted the audit observations in two cases.

(ii) Seven assessees, registered firms, filed the audit reports of chartered accountants for the assessment year 1985-86 before the specified date as extended by the Board but the self assessment tax payable within the normal period prescribed for filing the return was paid only after the due dates. In the assessment of all these cases completed between November 1985 and October 1989 the assessing officer did not initiate proceedings for levy of penalty for non-compliance with law nor recorded any reasons for not doing so. Penalty leviable on this account would work out to Rs.5.01 lakhs.

The department has accepted the audit observations in two cases.

(iii) The total turnover of three assessees, two registered firms and one individual, for the assessment years 1985-86, 1986-87 and 1988-89 assessed between November 1987 and January 1990 had exceeded rupees forty lakhs. The assessees were as such required to get their accounts audited by authorised accountants and furnish the reports of such audit in the prescribed form alongwith the returns of income. The statutory audit reports were neither attached with the return nor insisted upon by the assessing officer. For failure to observe the statutory provisions the assessee were liable to pay penalty totalling Rs.3.06 lakhs for these assessment years which was not imposed.

The department has accepted the audit observations in three cases.

Other topics of interest

Non-deduction of tax at source

4.34 Under the Income-tax Act, 1961, any person being a contractor responsible for paying any sum to any sub-contractor in pursuance of a contract with the sub-contractor for carrying out the whole or any part of the work undertaken by the contractor or for supplying whether wholly or partly, any labour which the contractor has undertaken to supply shall at the time of credit of such sum to the account of sub-contractor or at the time of payment thereof in cash or by issue of cheque or draft or by any other mode, deduct an amount equal to one percent of such sum as income-tax on income comprised therein. Further, any omission or failure to deduct tax as required in the Act attracts levy of penalty upto a maximum amount equal to tax at default and in addition, the defaulting payer shall pay interest at 15 percent per annum on the amount of such tax for the period for which the non-payment continued.

An assessee registered firm got works executed to the extent of Rs.107.22 lakhs through sub-contractors during the previous year relevant to the assessment year 1987-88. No tax was deducted at source from the payments made to the sub-contractor as required under the Act, except Rs.18,270 whereas the total tax deductible at source worked out to Rs.1.07 lakhs resulting in non-deduction of tax at source amounting to Rs.88,935. For failure to recover the tax at source from sub-contractors, the assessee firm was liable to pay penal interest and penalty amounting to Rs.1.26 lakhs which was not levied by the department.

Non-disallowance of expenditure in excess of Rs.2,500 paid otherwise than by crossed cheque/draft

4.35 The Income-tax Act 1961, provides for disallowance of expenditure incurred in business or profession for which payments are made in sums exceeding Rs.2,500 (since raised to Rs.10,000 from 1 April 1989) otherwise than by crossed cheque or crossed bank draft. This provision was designed to counter evasion of tax through claims for expenditure shown to have been incurred in cash with a view to frustrating proper investigation by the department as to the identity of the payees and the reasonableness of the amounts. Some cases and circumstances in which exemption from this requirement can be allowed have been provided in the rules. A residuary provision made in this regard states that exemption can be allowed where the assessee satisfies the Income-tax Officer not only about the genuineness of the payment and the identity of the payee but also that the payment could not be made by a crossed cheque/draft due to exceptional or unavoidable circumstances or was impracticable or that insistence on specified mode of payment would have caused genuine difficulty to the payee, having regard to the nature of the transaction and the necessity for expeditious settlement thereof.

It has also been judicially held[6] that for claiming the benefit of the provisions of this rule, it is not sufficient that the assessee establishes the genuineness of payment and the identity of the payee but should also prove that the circumstances mentioned in the rule existed and the required conditions were satisfied. In the absence of such evidence, such payments are not deductible in computation of income.

Under the Act, as made applicable from the assessment year 1985-86, assessees carrying on business or profession and having total sales turnover or gross receipts exceeding a specified limit should file, in respect of their accounts for each previous year, an audit report furnished by a chartered accountant in the prescribed form. The form of audit report provides for the auditor to

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list out payments in excess of Rs.2,500 made otherwise than by crossed cheque or crossed bank draft.

(i) In the case of 9 assessees, registered firms, in the audit reports enclosed to their returns of income for the assessment years 1985-86 to 1989-90, the chartered accountant had listed out payments in each case exceeding Rs.2,500 made otherwise than by crossed cheque/bank draft to the extent of Rs.143.87 lakhs. There was no indication whether these payments were made in exceptional circumstances as provided under the rules. No claim for exemption from disallowance was made nor were the circumstances of departure from provisions of law explained by the assessees or their auditors. No amounts were disallowed by the assessing officers while making the assessments between November 1987 and March 1990. The omission to add back these unexplained payments resulted in a short levy of tax aggregating to Rs.85.99 lakhs.

(ii) In the case of an individual, it was seen in audit that payments to the extent of Rs.4.42 lakhs were made in cash towards purchase of goods. There was no indication whether these payments were made in exceptional circumstances as provided under the rules. In the absence of valid reasons in support of the claim, these payments exceeding Rs.2,500 in each case, not made by a crossed cheque was required to be disallowed by the assessing officer. The omission to disallow the same and add back to income, resulted in underassessment of income of Rs.4.42 lakhs and consequential short levy of tax of Rs.2.21 lakhs.

CHAPTER 5

A WEALTH TAX

5.01 In the financial years 1986-87 to 1990-91, wealth tax receipts as against budget estimates were as given below:

Year	Budget Estimates	Actuals	Variation	Percentage
		(In crores of rupees)		
1986-87	100.00	174.15	74.15	74.15
1987-88	120.00	100.58	(-)19.42	(-)16.18
1988-89	120.00	122.48	02.48	02.06
1989-90	120.00	178.51	58.51	48.75
1990-91*	175.00	231.17	56.17	32.09

*Provisional

5.02 Particulars of cases finalised, assessments pending and demand in arrears for the five years ending 31 March 1991 are as given below:

Year	Number of assessments completed during the year	Number of cases pending assessment at the end of the year	Arrears of demand pending collection at the end of the year
			(In crores of rupees)
1986-87	10,65,944	4,68,762	204.42
1987-88	09,23,182	3,78,499	283.22
1988-89	06,95,326	3,19,267	406.78
1989-90	05,23,897	3,55,756	402.26
1990-91*	5,96,409	3,61,116	380.46

* Provisional

5.03 During the test audit of assessments completed under the Wealth-tax Act,1957, conducted during the period 1 April 1990 to 31 March 1991, short levy of wealth-tax of Rs.7.65 crores was noticed in 1645 cases. The mistakes broadly fall under the following categories:

Wealth tax on assessees other than companies

(i) Wealth not assessed

(ii) Incorrect valuation of assets

(a) Immovable properties

(b) Jewellery

(iii) Incorrect computation of net wealth

(iv) Incorrect exemptions

(v) Mistakes in application of rate of tax/calculation of tax

(vi) Non-levy/short-levy of additional wealth-tax

(vii) Non-levy of interest

(viii) Wealth-tax on companies

(a) Non-levy/short-levy of wealth-tax on companies.

(b) Incorrect valuation of immovable properties owned by companies.

79 draft paragraphs involving tax effect of Rs.131.73 lakhs were issued to the Ministry of Finance for comments during January 1991 to July 1991; the Ministry of Finance have accepted the observations in 10 cases. 4 cases were checked by the Internal Audit of the department but the mistakes were not detected by it. 32 important cases involving tax effect of Rs.74.74 lakhs illustrating the above mistakes are given in the following paragraphs.

Wealth-tax on assessees other than companies

5.04 Under the Wealth-tax Act,1957, wealth-tax on assessees other than companies is chargeable in respect of each assessment year on the net wealth of the assessees as on the valuation date relevant to that assessment year at the rates prescribed in the Schedule to the Act. Net wealth means the aggregate value of all assets wherever located

belonging to the assessee as reduced by the aggregate value of all admissible debts owed by him on the valuation date.

Wealth not assessed

1 The Public Accounts Committee had repeatedly emphasised the need for proper co-ordination amongst the assessment records pertaining to different direct taxes to ensure overall improvement in the administration of these taxes. The Central Board of Direct Taxes also have issued instructions (November 1973, April 1979 and September 1984) for proper co-ordination amongst assessment records pertaining to different direct taxes with a view to bring to tax cases of evasion of tax.

The income-tax assessment of a co-operative house building society, for the assessment year 1981-82 completed in November 1985 disclosed that the status of the assessee society was determined as an ` Association of persons'. Consequently, the assessee society was also liable to wealth-tax. But neither the assessee had filed any wealth-tax return for the assessment year 1981-82 nor were any wealth-tax proceedings initiated by the department. The omission resulted in escapement of wealth of Rs.45.66 lakhs with consequent non-levy of tax of Rs.1.73 lakhs.

The department has accepted the audit observation.

2. The Act ibid provides that where the assets are held under trust for any public purpose of a charitable or religious nature in India, no tax is payable by the assessee. However, wealth-tax is leviable upon and recoverable from the trustee or manager in respect of the property held by him under trust at the maximum marginal rate as applicable to an individual, if the trust forfeits exemption by reason of violation of any of the conditions specified in the Act.

(i) The income-tax assessment of an educational trust assessed as an association of persons, for the assessment year 1987-88 was completed in March 1990 on a total income of Rs.6.91 lakhs denying exemption of income

under the Income-tax Act. Audit scrutiny in May 1990 of the income-tax records of the assessee revealed that the trust had a taxable wealth of Rs.76.55 lakhs. But, no wealth-tax return was filed by the trust for assessment year 1987-88 nor did the department take any action to assess the wealth to tax. The omission resulted in non-levy of wealth-tax of Rs.1.50 lakhs calculated at the maximum marginal rate of two per cent of the wealth that escaped assessment.

Ministry of Finance have accepted the audit observation.

(ii) The income-tax assessment of an association of persons, for the assessment year 1986-87 was completed in March 1990 on a total income of Rs.11.94 lakhs. Audit scrutiny (April 1990) of the accounts of the assessee revealed that the association had a wealth of Rs.48.85 lakhs. But, no wealth-tax return was filed by the association of persons for the assessment year 1986-87 nor did the department take any action to assess the wealth. The omission resulted in non-levy of wealth-tax of Rs.1.42 lakhs (calculated at 3 per cent of the wealth escaped) since the individual shares of the beneficiaries were indeterminate.

Ministry of Finance have accepted the audit observation.

3. Under the provisions of the Wealth-tax Act,1957, where an assessee is a partner in a firm, the value of his interest in the firm is to be included in his net wealth.

In the wealth-tax assessments of an individual, for the assessment years 1976-77 to 1979-80, re-done in October 1988 and revised in March 1989, the balance in the assessee's current account with a firm in which he was a partner, amounting to Rs.7.98 lakhs, Rs.7.95 lakhs, Rs.7.78 lakhs and Rs.7.59 lakhs respectively,returned by the assessee, was not included. The omission resulted in underassessment of wealth of Rs.31.30 lakhs and short-levy of wealth-tax

of Rs.1.41 lakhs (including additional wealth-tax for assessment year 1976-77) in the aggregate.

Ministry of Finance have accepted the audit observation.

4. Under the Wealth-tax Act,1957, where any wealth has escaped assessment, proceedings may be initiated, if not more than ten years have elapsed from the end of the relevant assessment year when wealth that escaped assessment amounts to Rs.10 lakhs or more for that year.

(i) In the income-tax assessment of an assessee for the assessment year 1989-90 completed in March 1990, the Assessing Officer had observed that an immovable property held by the assessee since 1966, was sold by him in the relevant previous year in October 1988 for a consideration of Rs.8.50 lakhs, value of which according to the Valuation Officer's report of March 1990, as on the date of sale, was Rs.23.57 lakhs.The wealth-tax assessment records of the assessee for the past years revealed that the value of immovable property sold in October 1988 was not shown in the returns of wealth filed by the assessee nor was the same declared in the revised returns filed under the Amnesty scheme. The value of the immovable property was also not assessed to tax in the assessments for the assessment years 1981-82 to 1987-88, completed in July 1986 and November 1989, nor were any wealth-tax proceedings initiated by the department to assess the wealth which had escaped assessment, although action could have been taken from the assessment year 1981-82 onwards under the provisions of the Act. On the basis of the value of Rs.23.57 lakhs determined by the Valuation Officer on 9 March 1990, the market value of the property (considering 10 per cent reduction in each successive preceding years) escaped assessment ranging between Rs.19.09 lakhs and Rs.10.14 lakhs for the assessment years 1987-88 to 1981-82 respectively.The omission to assess the market value of the property thus resulted in underassessment of wealth of

Rs.99.57 lakhs in aggregate and short levy of wealth tax of Rs.1.92 lakhs.

(ii) In the income-tax assessment of a specified Hindu undivided family for the previous years relevant to assessment years 1982-83 to 1985-86 the assessee disclosed rental income of Rs.1.34 lakhs, Rs.92,851, Rs.59,451 and Rs.49,440 respectively. The value of one house property not related to industrial activity had all along been shown in the consolidated balance sheet and thus the net maintainable rent for the assessment year 1982-83 after deducting outgoings therefrom worked out to Rs.1.05 lakhs.Capitalising the net maintainable rent by the multiplier of 100/8 the fair market value under rent capitalisation method worked out to Rs.13.18 lakhs.The fair market value for the subsequent assessment years from 1983-84 to 1985-86 (so far income-tax returns filed and assessments completed) would not thus be less than the value of Rs.13.18 lakhs. Adopting this capitalised value and taking cash in hand as shown in balance sheet and deducting therefrom outstanding loan on mortgage of the building the wealth that escaped assessment during assessment years 1982-83 to 1985-86 would work out to Rs.13.46 lakhs, Rs.13.82 lakhs, Rs.13.25 lakhs and Rs.12.82 lakhs respectively.Omission to bring this wealth to tax resulted in non-levy of tax of Rs.1.26 lakhs.Neither the assessee had filed any wealth tax return nor did the department initiate any wealth-tax proceedings. Penalty provisions for non-filing of the returns were also attracted.

5. Under the Wealth-tax Act,1957, the value of assets transferred directly or indirectly otherwise than for adequate consideration by individual to a minor child (not being a married daughter) is to be included in the assessment of the transferor.These clubbing provisions are applicable to assets transferred after the end of the previous year relevant to assessment year 1971-72 and subsequent years by way of gift, even though such gift is chargeable under Gift-tax Act,1958, or is exempt from gift tax.

The income-tax assessment records of an individual, for the assessment years 1985-86 and 1986-87 revealed that he held in his name 8,698 equity shares of a public limited company valued at Rs.14.09 lakhs and Rs.26.27 lakhs as on 31 March 1985 and 31 March 1986 respectively. He had however, omitted to include them in his net wealth on the ground that the shares were held on behalf of his minor children. Similarly, the wealth-tax assessment record of the assessee for earlier years revealed that he had transferred to his minor children, 3,500 equity shares of a company for inadequate consideration during the previous year relevant to assessment year 1981-82, but had included in his net wealth only the proportionate market value of the shares at Rs.2.44 lakhs and Rs.4.55 lakhs instead of their full value. The omission to include the full value of the shares resulted in escapement of wealth of Rs.3.23 lakhs and Rs.6.02 lakhs respectively in the assessment years 1985-86 and 1986-87. The total value of shares omitted to be included in his net wealth thus amounted to Rs.17.32 lakhs and Rs.32.29 lakhs for the assessment years 1985-86 and 1986-87 respectively. This resulted in aggregate short levy of tax of Rs.1.44 lakhs (including penalty for delay in furnishing the returns of wealth).

The department stated that assessments for both years had been set aside.

Incorrect valuation of assets

5.05 (a) **Immovable properties**

1. Under the Wealth-tax Act,1957, the value of any property shall be estimated to be the price which in the opinion of the Wealth-tax Officer, it would fetch if sold in the open market on the valuation date.

(i) The wealth-tax assessment of an individual for the assessment year 1982-83 was completed in February 1987 and those for the assessment years 1983-84 to 1986-87 in February 1988 adopting the value of land and building as Rs.8.58 lakhs, Rs.10.50 lakhs, Rs.11.38 lakhs, Rs.14.75 lakhs and Rs.17.13 lakhs for the five assessment years respectively. Audit scrutiny in November 1988

revealed that as per the income-tax assessment records, the assessee had entered into an aggreement in March 1988 for sale of the above property for a sale consideration of Rs.65 lakhs.As the value adopted in the assessments for the assessment years 1982-83 to 1986-87 was very low, when compared to the sale value which represented the true market value as on 31 March 1988, the earlier years' assessments should have been re-opened to adopt the real market value on the relevant valuation date. Adopting a 10 per cent reduction in the value of the property for each previous year, the market value of the property on ,the valuation dates relevant to the assessment years 1982-83 to 1986-87 would have been Rs.34.54 lakhs, Rs.38.38 lakhs, Rs.42.65 lakhs, Rs.47.39 lakhs and Rs.52.65 lakhs respectively. Omission to adopt these values resulted in under-assessment of wealth aggregating to Rs.153.28 lakhs for five assessment years respectively with consequent aggregate short levy of tax of Rs.6.03 lakhs.

(ii) The wealth-tax assessments of two individuals for the assessment year 1985-86 were completed in March 1990 adopting the value of one-third share held by each of them in the land and building in a studio complex at Rs.29.44 lakhs and at Rs.29.95 lakhs respectively as returned by them. Audit scrutiny in July 1990 revealed that in the case of one assessee the value of his one-third share in the property was adopted at Rs.44.96 lakhs in the assessment for the assessment year 1984-85 completed in March 1989, on the basis of the valuation report of the Departmental Valuation Officer.As the value of the propeties cannot decline with passage of time in the context of spiralling real estate prices, the value of the property for assessment year 1985-86 should at least have been adopted as for assessment year 1984-85. The mistake resulted in under-assessment of wealth aggregating to Rs.30.54 lakhs and short levy of tax of Rs.1.45 lakhs.

2. Under the Act **ibid**, the methods generally adopted to estimate the market value of any buildings are the `land and building method' and `income captalisation

method'. It has been held[1] judicially that the income capitalisation method is ideally suited for estimating the fair market value of commercial properties.

(i) In computing the net wealth of a Hindu undivided family for the assessment years 1986-87 to 1988-89 in July 1989, the assessing officer adopted the fair market value of property at Rs.16.98 lakhs (on the basis of valuation adopted for the assessment year 1983-84) worked out under ` income capitalisation method'. A test check of the income-tax assessment records of the assessee disclosed that the net rental income of the property increased to Rs.2.56 lakhs, Rs.2.68 lakhs and Rs.2.63 lakhs in the assessment years 1986-87 to 1988-89 respectively. On the basis of ` income capitalisation method, the value of the aforesaid property would work out to Rs.30.76 lakhs, Rs.32.17 lakhs and Rs.31.57 lakhs for the assessment years 1986-87 to 1988-89 respectively. Omission to adopt the higher valuation of property resulted in an aggregate under assessment of wealth of Rs.43.56 lakhs and short levy of tax of Rs.1.31 lakhs in aggregate.

The department has accepted the audit observation.

(ii) The Wealth-tax Act,1957, provides that the Wealth-tax officer may make a reference to the Departmental Valuation Officer for the valuation of assets where the value as returned on the basis of registered valuer's report, in his opinion, is less then its fair market value and the fair market value of the asset exceeds the value of the asset as returned by more than 33 1/3 per cent or Rs.50,000. The Act also provides that the order of the Valuation Officer in respect of the asset shall be binding on the assessing officer. As per executive instructions issued by the Central Board of Direct Taxes in June 1970, where the value of the property in respect of any assessment year exceeds the declared consideration in respect of any earlier year by more than 25 per cent the

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1. Govindarajulu Vs. C.I.T. (1975) (100-ITR-621 - Kar H.C.)

assessment of the earlier years should be re-opened for revaluation of the property.

(a) An individual was owner of several immovable properties in a metropolitan city. In the wealth-tax assessment of the assessee for the assessment year 1984-85 completed in March 1990, the assessing officer adopted the value of immovable properties at Rs.159.02 lakhs as per the report of the Departmental Valuation Officer. Audit scrutiny revealed (March 1991) that the assessing officer had adopted the value of the said immovable properties at Rs.9.66 lakhs on estimate basis in the assessment for the earlier assessment year 1983-84 completed in March 1988. In view of the very large difference between the value adopted for the assessment year 1984-85 and that taken for the assessment year 1983-84, the assessing officer should have re-opened the assessment for the assessment year 1983-84. Considering 10 per cent appreciation in value in the later year, the market value of the properties for the assessment year 1983-84 would work out to Rs.144.57 lakhs instead of Rs.9.66 lakhs taken in assessment.The omission resulted in underassesment of net wealth of Rs.134.91 lakhs with consequent short levy of tax of Rs.6.37 lakhs.

(b) Four individuals having equal shares were co-owners of a property in a metropolitan city. In the wealth-tax returns for the assessment year 1984-85, the value of one-fourth share was shown by the assessees at Rs.2.49 lakhs, Rs.2.50 lakhs, Rs.2.38 lakhs and Rs.2.38 lakhs respectively.It was noticed in audit (February 1991) that the Valuation Officer of the department had intimated in March 1988 that the fair market values of the whole property as on the valuation dates 20 April 1983 and 9 April 1984 relevant to the assessment years 1983-84 and 1984-85 were Rs.68.10 lakhs and Rs.97.71 lakhs respectively.The assessing officer, while completing the wealth-tax assessment of two assessees for assessment year 1984-85 in March 1989, inadvertantly took the value of one-fourth share in the said property at Rs.17.03 lakhs (applicable for the

assessment year 1983-84) in place of Rs.24.43 lakhs. This resulted in under-assessment of wealth of Rs.14.80 lakhs in aggregate, in the case of two assessees.

In the wealth-tax assessment of the other two co-owners, completed in July 1987, the assessing officer accepted the value in the property at Rs.2.38 lakhs each as returned by the assessees.The assessing officer did not re-open the assessments of these two assessees in the wake of the valuation report of the Department.The omission resulted in underassessment of wealth of Rs.44.10 lakhs in aggregate.

The cumulative effect of these mistakes was, thus, an under-assessment of wealth of Rs.58.90 lakhs with consequent short levy of tax of Rs.2.08 lakhs in aggregate.

(c) A Hindu undivided family (HUF), in their wealth tax returns for the assessment years 1977-78 to 1981-82 returned the value of a residential property at Rs.1.39 lakhs on the basis of the report dated 24 July 1977 of a registered valuer which was accepted by the assessing officer. Audit scrutiny (October 1986) revealed that this property was valued at Rs.3.25 lakhs in the preceding assessment years. As the fair market value of the property as adopted in earlier assessment years had been far more than the value as returned on the basis of the report of a registered valuer, reference of the property by the assessing officer to the Departmental Valuation Cell for valuation was necessary.

The income-tax assessment records of the assessee for assessment year 1982-83 and wealth-tax assessment records for assessment year 1977-78 and earlier years disclosed that the assessee had not returned the value of a non-agricultural plot of land measuring 16,940 sq.yards in his wealth tax returns for the assessment years 1978-79 to 1981-82 which went undetected by the department. In addition, in the assessment year 1981-82 the assessee claimed incorrect exemption of two non-agricultural plots of land measuring 8,300 sq.yards declaring the same as

agricultural which was allowed by the assessing officer. Moreover, in the assessment for the assessment year 1980-81 the status of the assessee was Hindu undivided family to whom higher rates of tax were leviable whereas the department adopted the status of the assessee as Hindu undivided family (non-specified) and thus applied the lower rates of tax.

The cumulative effect of the above omission was short levy of tax of Rs.23,700 besides penalties as pointed out by Audit in October 1986. The department referred the properties to the Departmental Valuation Officer who, in his report (March 1989), valued the fair market value on the relevant valuation dates on the basis of which the assessments for assessment years from 1978-79 to 1981-82 were revised (January 1990) creating additional demand of Rs.2.90 lakhs besides penalties.The audit scrutiny (March 1990) of revised assessments for assessment years 1979-80 to 1981-82 completed on 25 January 1990, by the assessing officer revealed that he had omitted to include the value of a plot of land measuring 9,831 sq. metres as per report (March 1989) of the Departmental Valuer. This resulted in escapement of taxable wealth of Rs.11.80 lakhs, Rs.12.78 lakhs,Rs.13.77 lakhs in assessment years 1979-80 to 1981-82 respectively with further short levy of wealth tax of Rs.1.46 lakhs.

The aggregate short charge of tax thus worked out to Rs.4.36 lakhs, besides penalty leviable for furnishing inaccurate particulars of wealth for aforesaid assessment years.

The department has accepted the audit observation.

(b) Jewellery

In the case of an individual, the assessee returned the value of jewellery owned by him at Rs.5 lakhs on the valuation dates 31 March 1982 and 31 March 1985 relevant to the assessment years 1982-83 and 1985-86 respectively. In the assessment completed on

23 March 1990 for the assessment year 1976-77 the value of jewellery was estimated at Rs.8 lakhs against the returned value of Rs.5 lakhs without calling for the valuation report.The value of gold which was Rs.532 per 10 grammes on 31 March 1976 (assessment year 1976-77) had increased to Rs.1645 on 31 March 1982 and Rs.3130 on 31 March 1985 relevant to the assessment years 1982-83 and 1985-86 respectively.On that basis the value of jewellery adopted at Rs.5 lakhs for both the above assessment years (assessment completed on 23 March 1990) should have been adopted at Rs.24.74 lakhs and Rs.32.03 lakhs for the assessment years 1982-83 and 1985-86 respectively. Incorrect valuation of jewellery adopted, resulted in underassessment of wealth of Rs.46.77 lakhs and consequent short levy of wealth-tax of Rs.2.23 lakhs in aggregate.

Ministry of Finance have accepted the audit observation.

Incorrect computation of net wealth

5.06 Under the Wealth-tax Act,1957, the net wealth of an assessee means the aggregate value of all assets wherever located belonging to the assessee as reduced by the aggregate value of all admissible debts owed by him on the valuation date.

The wealth-tax assessments of an individual, for the assessment years 1984-85 and 1985-86 were completed in March 1990 on a net wealth of Rs.24.26 lakhs and Rs.35.37 lakhs respectively. Audit scrutiny in December 1990 revealed that while computing the net wealth of the assessee for both the years, the assessing officer had adopted the wealth under `movables' at Rs.3.79 lakhs instead of at the correct amount of Rs.15.14 lakhs as returned by the assessee in the return.The mistake resulted in an under-assessment of wealth of Rs.11.35 lakhs for each year involving an aggregate short levy of tax of Rs.1.08 lakhs.

The assessing officer has accepted the audit observation for assessment year 1984-85, while for assessment year 1985-86 he replied that the assessment was completed to the best

of his judgement and appeals were pending for both the years before appellate authorities.

Incorrect exemptions

5.07.1. Under the provisions of the Wealth-tax Act,1957, no wealth-tax is payable by an assessee in respect of one or more dwelling units, each having a plinth area not exceeding 80 square metres, and the land appurtenant thereto, for a period of five successive assessment years next following the date of completion of construction of the dwelling unit/ units.It has been clarified in the Act itself that the exemption will be available only for dwelling units used solely for the purpose of residence.

In the wealth-tax assessments of an individual, for the assessment years 1984-85, 1985-86 and 1986-87, completed in June 1987, 13, 13 and 10 dwelling units respectively, valued at Rs.9.75 lakhs, Rs.9.75 lakhs and Rs.7.00 lakhs respectively, were exempted from payment of wealth-tax under the above provisions of the Act. It was noticed in audit that, according to a report of the Income-tax Inspector (available in the assessment records for the assessment year 1982-83), none of the 13 dwelling units exempted in the assessments for the assessment years 1984-85 and 1985-86 had been occupied on the relevant valuation dates, and that out of the 10 units exempted in the assessment for the assessment year 1986-87, only 4 units had been occupied on the relevant date, and that too, only three for residential purposes. Units not yet occupied on the relevant valuation dates and the one occupied for purposes other than residential could not be deemed to have been `used solely for the purpose of residence', and the exemption granted to these units was, therefore, not in order. The mistakes resulted in underassessment of wealth of Rs.9.75 lakhs, Rs.9.75 lakhs and Rs.4.90 lakhs respectively in the assessment years 1984-85, 1985-86 and 1986-87 and consequent short-levy of tax of Rs.75,066 in the aggregate.

Ministry of Finance have accepted the audit observation.

2. Under the Wealth-tax Act,1957, the maximum exemption in respect of specified financial assets should not exceed two hundred and sixty five thousand rupees for the assessment year 1985-86.

The wealth-tax assessment of an individual for the assessment year 1985-86 was completed in March 1990 on a net wealth of Rs.20.24 lakhs allowing exemption of Rs.13.70 lakhs (as against Rs.10.85 lakhs claimed by the assessee) in respect of assets forming part of the assessee's industrial undertaking. The value of the assets of the industrial undertaking was exempt from wealth-tax subject to the ceiling of Rs.2.65 lakhs.Audit scrutiny in November 1990 revealed that full exemption of Rs.2.65 lakhs had been separately allowed to the assessee. Further allowance of Rs.13.70 lakhs therefore resulted in under-assessment of wealth of Rs.13.70 lakhs involving a short levy of tax of Rs.65,220.

Mistake in application of rate of tax/calculation of tax

5.08 A. Application of rate of tax

As per Schedule to the Wealth-tax Act, 1957, as amended by the Finance Act, 1979, with effect from 1 April 1980, applicable to the assessment year 1980-81, where the net wealth of an individual exceeds Rs.15 lakhs, tax leviable is Rs.28,750 plus 5 per cent of the amount by which the net wealth exceeds Rs.15 lakhs.

While completing the wealth tax assessment of an individual, for the assessment year 1980-81, to the best of his judgement in March 1990, the assessing officer determined the total wealth of the assessee at Rs.1 crore (before allowing wealth-tax liabilities) and levied wealth-tax of Rs.3.08 lakhs thereon. It was, however, noticed in audit (February 1991) that while calculating the wealth-tax leviable the assessing officer applied the lower rate of tax applcable to the assessment year 1979-80 and incorrectly worked out the tax leviable at Rs.3.08 lakhs instead of the correct amount of Rs.4.32 lakhs for the assessment year 1980-81. The mistake in calculation of tax resulted in short levy of

tax of Rs.5.28 lakhs (including short levy of penalty for non-furnishing of return and concealment of particulars of assets to the tune of Rs.2.80 lakhs and Rs.1.24 lakhs respectively).

B.Calculation of tax

While completing the wealth-tax assessment of an individual for the assessment year 1985-86 in March 1990, on a net wealth of Rs.184.35 lakhs, the assessing officer incorrectly calculated the wealth tax as Rs.4.75 lakhs instead of the correct amount of tax of Rs.8.34 lakhs.The mistake in calculation of tax resulted in short-levy of wealth-tax of Rs.3.59 lakhs.

Ministry of Finance have accepted the audit observation.

Non-levy/ short levy of additional wealth-tax

5.09 Under the Wealth-tax Act,1957, before its amendment by the Finance Act,1976, where the net wealth of an individual or a Hindu undivided family, included buildings or lands(other than business premises) or any right therein, situated in an urban area, additional wealth-tax was leviable on the value of such urban assets exceeding rupees five lakhs.

While revising the wealth-tax assessments, for the assessment years 1965-66 to 1971-72, in October 1989 to give effect to appellate orders, the net wealth of an individual included, inter alia, an urban house property valued at Rs.62.06 lakhs in aggregate on which additional wealth-tax of Rs.1.35 lakhs was leviable in these seven years which was not levied by the department.The omission resulted in undercharge of tax of Rs.1.35 lakhs.

Non-levy of penalty and interest

5.10 A. Penalty

Under the Wealth-tax Act, 1957, if any assessee fails to furnish the return required to be filed under the Wealth-tax Act within the time allowed, the assessing authority may impose a penalty calculated at the rate of two per cent of the assessed tax for every

month during which the default continued. Similarly, if any assessee fails to pay the self assessment tax, the assessing authority may impose a penalty calculated at the rate of two per cent of such tax remaining unpaid for every month of default.The Central Board of Direct Taxes clarified in March 1974 that in cases where penal action is not initiated the assessing officer should record the reasons in the order sheet or append a note to the assessment order giving reasons therefor.

An assessee, a Hindu undivided family, filed return of wealth for the assessment years 1985-86, 1986-87 and 1987-88 on 29 December 1986, 31 December 1986 and 31 March 1989 respectively. Self-assessment tax for all these years was paid on 14 March 1990. The extension of time for filing return for assessment year 1985-86 was applied for by the assessee on five occasions the last being upto 31 July 1986 and for assessment years 1986-87 and 1987-88 the extention was sought on two occasions each i.e., upto 31 December 1986 and upto 31 March 1988 respectively stating that the details of wealth were not finalised. The records did not indicate whether the extention asked for were actually granted by the assessing officer. The assessment orders were also silent on the question of initiation of penal action for delay in filing the return and for delay in payment of self assessment tax. The assessee was in any case liable for penalty for delay beyond the period for which extension was sought.The penalty leviable for late filing of return thus worked out to Rs.23,144 and for late payment of self assessment tax to Rs.1.19 lakhs.The omission to levy penalty resulted in aggregate short levy of tax of Rs.1.42 lakhs.

B. Interest

Under the Wealth-tax Act, 1957, an assessee is deemed to be in default if the amount specified in the notice of demand is not paid within thirty five days of the service of the notice of demand and for the period of default, the assessee is liable to pay simple

interest at the rate of twelve per cent (fifteen per cent from October 1984 and 1.5 percent per month or part of month from 1 April 1989) per annum of the tax so demanded till it is paid.

(i) The wealth-tax assessment of an individual, for the assessment year 1984-85, was completed in March 1989 on a taxable wealth of Rs.403.33 lakhs raising a demand of Rs.16.04 lakhs. The demand was subsequently reduced to Rs.10.20 lakhs in April 1989.Audit scrutiny in September 1990 revealed that the demand which fell due in May 1989 was collected in August 1989 by cash and in August 1990 by adjustment against refund due to the assessee for the assessment year 1989-90 but no interest for belated payment of tax was levied.The omission resulted in non-levy of interest of Rs.1.35 lakhs.

(ii) The wealth-tax assessment of an individual, for the assessment years 1980-81 and 1981-82 were completed originally in March 1985 and October 1985 raising demands of Rs.94,085 and Rs.1.43 lakhs respectively which were reduced to Rs.86,315 and Rs.1.33 lakhs consequent on the revisions made in August 1989.The demands were paid in full in September 1989. Audit scrutiny in July 1990 revealed that though the demands were paid belatedly by the assessee, the interest leviable for the belated payment of tax aggregating to Rs.1.31 lakhs for the two years had not been levied and collected.

Ministry of Finance have accepted the audit observation.

Wealth-tax on companies

5.11 Companies, other than the companies in which public are substantially interested, are liable to wealth-tax from the assessment year 1984-85 at a flat rate of two per cent (plus surcharge at ten per cent for the assessment year 1988-89 only) of the market value of the specified assets including building or land appurtenant thereto otherthan building used by the assessee as factory, godown, warehouse, hotel or office (and also cinema building from 1 April 1989), and their value shall be estimated to be the

price which in the opinion of the assessing officer, they would fetch, if sold in the open market on the valuation date.

(a) Non-levy/short-levy of wealth-tax on companies

(i) The income-tax assessment records of a closely held company, for the assessment years 1984-85 to 1989-90 revealed that the company owned building which was let out and rent received from it was assessed as income from house property, and on the basis of rent of Rs.89,493 in the assessment year 1984-85, the value of the property under rent capitalisation method, would work out to Rs.8.47 lakhs.The company also owned cinema buildings and land appurtenant thereto the value of which, in absence of any information regarding market value (and ignoring appreciation of their value and depreciation as per books), would be Rs.11.63 lakhs in the assessment year 1984-85 and Rs.11.75 lakhs, in the assessment years 1985-86 to 1988-89, being the cost as shown in the balance sheets.

The assessee furnished wealth-tax returns, for the assessment years 1984-85 to 1988-89 on 1 May 1989 declaring value of cars only and the assessments on the basis of these returns were completed by the department in March 1991.The value of let out buildings and cinema buildings was neither returned by the assessee nor assessed by the department while completing the wealth-tax assessments.The omission to assess the aforesaid immovable properties resulted in escapement of wealth of Rs.23.38 lakhs and short levy of tax of Rs.2.23 lakhs in aggregate.

Ministry of Finance have accepted the audit observation.

(ii) The income-tax assessment records of a private limited company(in which public are not substantially interested) for the assessment year 1986-87 completed in March 1989 indicated that the company owned flats of value of Rs.103.10 lakhs on which the company was liable to pay wealth-tax. The

company however, did not file its return of wealth nor had the Department taken any action to initiate wealth-tax proceedings. The omission resulted in escapement of wealth of Rs.103.10 lakhs and non-levy of tax of Rs.2.02 lakhs.

(iii) The income-tax assessment of a closely held company for the assessment year 1984-85 was completed in December 1984 assessing the taxable income at Rs.6.79 lakhs. It was noticed therefrom that the assessee company was in receipt of an annual rental income of Rs.5.40 lakhs in respect of its building let out for commercial purposes.Since the above building was not used for the purposes of the business of the assessee company, it was liable to be assessed to wealth-tax. Audit scrutiny(July 1987) revealed that no wealth-tax return was filed by the company nor did the department initiate any action to call for the same.On the basis of the rental income the wealth escaping assessment amounted to Rs.47.09 lakhs computed under rent capitalisation method.

The assessing officer completed the wealth-tax assessment in March 1990 adopting the value of the building at Rs.139.33 lakhs as per the Departmental Valuation Officer and raised a demand of Rs.2.32 lakhs of which the tax effect attributable to audit worked out to Rs.1.60 lakhs.

Ministry of Finance have accepted the audit observation.

(iv) The income-tax assessment records of a private limited company in which the public are not substantially interested for the assessment years 1984-85,1985-86 and 1986-87 (assessments completed between July 1986 and March 1989) indicated that the company owned buildings and lands of the net aggregate value of Rs.75.41 lakhs on which the company was liable to pay wealth-tax. The company however, did not file its return of wealth nor did the department take action to call for the same. The omission resulted in

escapement of wealth of Rs.75.41 lakhs and non levy of tax of Rs.1.51 lakhs.

The department has accepted the audit observation.

(v) In the income-tax assessment of a closely held company for the previous year 1986-87 relevant to assessment year 1987-88 the assessee disclosed rental income of Rs.3.28 lakhs from two buildings.The net maintainable rent of Rs.2.73 lakhs was brought to tax after deducting outgoings of Rs.54,667 therefrom. Rent realisation for the assessment year 1986-87 was shown in the same accounts at Rs.2.62 lakhs under previous years figure.Thus maintainable rent for the assessment year after deducting 1/6th for repairs would work out to Rs.2.18 lakhs. Capitalising the net maintainable rent by the multiplier of 100/9 for commercial building, the fair market value of the properties under rent capitalisation method for the assessment years 1986-87 and 1987-88 would worked out to Rs.24.27 lakhs and Rs.30.37 lakhs respectively.The fair market value for the subsequent assessment years **i.e.**,1988-89 and 1989-90 would not be less than the value of Rs.30.37 lakhs (rent figures are not available). The wealth-tax return for any of the aforesaid assessment years was neither filed by the assessee nor called for by the department.Thus, wealth aggregating to Rs.115.38 lakhs escaped assessment for assessment years 1986-87 to 1989-90 on which wealth-tax payable was Rs.2.31 lakhs. Non-filing of returns for any of the assessment years would also attract levy of penalty of Rs.2.31 lakhs being the equivalent amount of tax sought to be evaded.

Ministry of Finance have accepted the audit observation.

(b) Incorrect valuation of immovable properties owned by the companies

1. The value of the specified assets shall be estimated to be the price which in the opinion of the Wealth-tax Officer, they would fetch if sold in the open market on the

valuation date. The valuation of assets of the companies for the purpose of wealth-tax is to be made in the manner stated above and the valuation is not subject to any Rules made under the Wealth-tax Act for the purpose of determining the value of assets under the provisions of Finance Act, 1983.

In the wealth-tax assessments of three private limited companies, the value of the flats owned by the assessee companies was incorrectly adopted in terms of Rule 1BB of Wealth-tax Rules,1957, instead of the market value to be adopted under the provisions of Finance Act,1983. The particulars of the cases are:

(i) A private limited company owned two residential flats admeasuring 1951 sq.ft. and 1140 sq.ft. in a posh locality of Bombay city. In the wealth tax returns for the assessment years 1984-85 to 1986-87, the value of the flats were returned at Rs.6.83 lakhs and Rs.3.73 lakhs respectively under the Wealth-tax Rules,1957 (Rule 1 BB) which were assessed at Rs.7.67 lakhs and Rs.4.14 lakhs by the assessing officer in the wealth-tax assessment completed in September 1988 applying Rule 1BB. The assessee being a company, market value of the flats were includible in the net wealth of the assessee and not the value as determined under the Wealth-tax Rules. Considering even a modest rate of Rs.2,000 per square ft.which is not absolute and which is being adopted for determining the value, the market value of the flats, being in a posh locality of Bombay city, would work out to Rs.33.02 lakhs and Rs.22.80 lakhs. Incorrect valuation of the flats resulted in under-assessment of wealth of Rs.44.01 lakhs in each of the assessment years 1984-85 to 1986-87 with consequent aggregate short levy of tax of Rs.2.64 lakhs.

(ii) In the wealth-tax returns of another private limited company, the assessee returned the value of three flats (located in posh areas of Bombay and Pune cities) at Rs.58,489, Rs.41,144 and Rs.48,111 respectively for the assessment year 1987-88 and Rs.62,467, Rs.46,287 and Rs.54,125

respectively for the assessment year 1988-89 under Rule 1 BB of Wealth tax Rules, 1957. The values so returned were accepted by the assessing officer in the wealth-tax assessments completed in October 1988 and December 1988. The assessee being a company, market value alone of the flats was required to be adopted in the wealth of the assessee as the valuation of the property under the Wealth-tax Rules, was not provided in the provisions of Finance Act, 1983. Considering even a modest rate of Rs.2,000 per sq.ft.for the purpose of determining the value of the property, the market value of one flat in posh locality of Bombay city would work out to Rs.36 lakhs.The incorrect valuation of this flat alone resulted in under assessment of wealth of Rs.35.41 lakhs and Rs.35.37 lakhs for the assessment years 1987-88 and 1988-89 respectively with consequent short levy of tax of Rs.1.41 lakhs.

(iii) In the case of yet another private limited company, the assessee company owned a number of flats occupied by its employees. In the wealth-tax returns, the assessee returned the value of these flats at Rs.40.19 lakhs and Rs.43.02 lakhs respectively, for the assessment years 1987-88 and 1988-89 under the rent capitalisation method, provided in Rule 1 BB of Wealth-tax Rules,1957. The value so returned was accepted by the assessing officer in the wealth-tax assessments. The assessee being a private limited company, market value alone of the flat was required to be adopted in the wealth of the assessee as the valuation of the property under the Wealth-tax Rules, was not provided in the provision of Finance Act, 1983. By adopting the market value of the property approximately at fifty per cent more of the value offered, the under-assessment of wealth would work out to Rs.20.09 lakhs and Rs.21.51 lakhs for the assessment years 1987-88 and 1988-89 respectively involving an aggregate short levy of tax of Rs.81,578.

The department did not accept the observations, in the case of two companies stating inter alia, that Rule 1BB formed part of the Wealth-tax Act ibid and market value

of immovable properties had rightly been assessed.The reply of the department is not maintainable in terms of Section 40(4) of Finance Act, 1983 which only provides for an exception in cases covered under Section 7(3) of the Wealth-tax Act,1957.

2. In the wealth-tax assessment of a private limited company, for the assessment years 1984-85, 1985-86 and 1986-87 the value of land was taken at Rs.16,769 for all the three assessment years. A scrutiny of the income-tax assessment records of the assessee revealed that the land in question with a book value of merely Rs.63 was converted into stock in trade at a value of Rs.1.20 crores in June 1986. Since the land was converted into stock-in-trade at a cost of Rs.1.20 crores in June 1986, which was very close to the valuation date being March 1986 for the assessment year 1986-87, the value of land was to be adopted at Rs.1.20 crores for the purpose of levy of wealth-tax. Similarly, for the assessment year 1985-86 the value of the said immovable property was to be adopted at Rs.1 crore approximately and for the assessment year 1984-85 at Rs.75 lakhs in the absence of correct valuation report. Failure to adopt the market value of the immovable property, resulted in aggregate under assessment of wealth of Rs.2.95 crores and aggregate short levy of wealth-tax of Rs.5.89 lakhs for all the three assessment years.

The department has accepted the audit observation.

B-GIFT TAX

5.12 In the financial years 1986-87 to 1990-91, gift-tax receipts vis-avis the budget estimates were as given below:

Year	Budget Estimates (in crores of rupees)	Actuals	Variation	Percentage
1986-87	15.00	9.26	(-)5.74	(-)38.27
1987-88	11.00	8.23	(-)2.77	(-)25.18
1987-88	10.00	6.74	(-)3.26	(-)32.60

1989-90	9.50	8.07	(-)1.43	(-)15.05
1990-91*	9.00	3.38	(-)5.62	(-)62.44

*Provisional

5.13 Particulars of cases finalised, assessments pending and demands in arrears, for the five years 1986-87 to 1990-91 are as given below:

Year	**No.of assessments completed during the year**	**No. of cases pending assessment at the end of the year**	**Arrears of demands pending collection at the end of the year (In crores of rupees)**
1986-87	76,154	39,097	19.46
1987-88	64,375	30,517	22.02
1988-89	70,642	21,327	24.53
1989-90	52,560	18,683	62.61
1990-91*	46,621	15,951	52.25

*Provisional

5.14 During the test audit of assessments made under the Gift tax Act,1958, conducted during the period 1 April 1990 to 31 March 1991 short levy of gift tax of Rs.3.55 crores was noticed in 269 cases. The following types of mistakes were noticed.

(i) Non-levy of tax on deemed gift

(ii) Incorrect valuation of gifts of immovable properties

Out of a total number of 25 draft paragraphs involving tax effect of Rs.248.34 lakhs issued to the Ministry of Finance for comments during January 1991 to July 1991, the Ministry of Finance have accepted the observations in 4 cases. 2 of these cases were checked by the internal Audit of the department but the mistakes were not detected by it. 11 important cases (involving revenue effect of Rs.237.31 lakhs) illustrating the above mistakes are given in the following paragraphs.

Non-levy of tax on deemed gift.

5.15.1 Under the Gift-tax Act, 1958, where the property is transferred otherwise than for adequate consideration, the amount by which the market value of the property on the date of transfer exceeds the declared consideration, shall be deemed to be a gift made by the transferor and is chargeable to gift-tax. The Act further provides that the value of the property shall be estimated to be the price which it would fetch, if sold in the open market on the date on which the gift is made.

(i) The income-tax assessment records of a private limited company for the assessment year 1989-90 disclosed that 3 flats in a building in metropolitan city constructed during the previous year relevant to the assessment year 1984-85 were sold during the previous year relevant to the assessment year 1989-90. The building constructed by the assessee company consisted of 12 flats out of which three flats were sold. While one flat costing Rs.39 lakhs was sold for Rs.1.06 crores, other two flats costing Rs.26.82 lakhs each were sold for Rs.9 lakhs each. Considering the steep rise in the market value of residential flats, the apparent sale consideration of the two flats was too low. Considering the percentage of profit in the sale of the flat costing Rs.39 lakhs, the capital gain in respect of the other two flats would work out to Rs.64.22 lakhs each. The sale of the two flats at a loss of Rs.17.82 lakhs each thus constituted deemed gift of Rs.1.28 crores. However, neither the assessee had filed any return of gift nor did the department initiate any action to call for the same. The omission resulted in non-levy of gift-tax of Rs.38.47 lakhs.

Ministry of Finance have accepted the audit observation.

(ii) The income-tax assessment records of a closely held company revealed that the assessee company had sold in January 1985 land and buildings for a consideration of Rs.119.69 lakhs. The actual sale deed was registered in August 1986. Audit scrutiny (September 1990) revealed that the fair

market value of the above land and buildings were determined at Rs.159.77 lakhs as on the date of transfer (viz. August 1986) by the District Valuation Officer for purposes of acquisition under Chapter XXA of the Income-tax Act. The difference of Rs.40.08 lakhs between the market value (Rs.159.77 lakhs)and the value at which the land and buildings were sold (Rs.119.69 lakhs) constituted deemed gift attracting levy of gift-tax. Although the information regarding determination of the fair market value of the land and the buildings by the District Valuation Officer at Rs.159.77 lakhs on the date of transfer was available with the department, no gift tax proceedings for levy of gift-tax were initiated by the department. The omission resulted in escapement of gift of Rs.40.08 lakhs and consequently non-levy of gift tax of Rs.11.96 lakhs. Besides tax, penalty of Rs.9.33 lakhs for non-filling of the gift-tax return was also leviable.

(iii) The income-tax assessment records of an individual for the assessment year 1989-90 (assessment completed in March 1990) disclosed that a house and a plot of land were sold by the assessee in October 1988 for a consideration of Rs.8.50 lakhs, while the value of the property according to the valuation made by the Valuation Officer in March 1990 as on the date of sale was Rs.23.57 lakhs. Though the assessing officer recorded in the assessment order that the difference of Rs.15.07 lakhs was a deemed gift under the Act ibid no gift tax proceedings were initiated by the department. The omission resulted in escapement of gift of Rs.15.07 lakhs and non-levy of gift-tax of Rs.4.46 lakhs.

Ministry of Finance have accepted the audit observation.

(iv) A private limited company transferred to one of its subsidiaries with effect from 1 April 1985 relevant to the assessment year 1986-87, certain assets and liabilities at their book value as on the date of transfer for a consideration of Rs.99,750 representing 9,975 fully paid-up equity share of the

subsidiary. The net assets on the date of transfer was valued at Rs.99,768. It was observed in audit (February 1991) that a house property in the posh area of a metropolitan city and 41,175 equity shares of a company (included in the assets) were transferred at their book value of Rs.5.25 lakhs and Rs.4.40 lakhs respectively. The house property was an eight-storeyed building which was partly let out and partly occupied by the assessee company. The first floor of the property with a floor measuring 3000 sq.ft. was sold to its occupier tenant in March 1985 for a consideration of Rs.15 lakhs. Considering the sale price of the first floor of the property in place of Rs.5.25 lakhs shown in the balance sheet, the value of remaining floors measuring 16,084 sq.ft. would work out to Rs.80.42 lakhs. Further, the value of 41,175 equity shares, quoted in the stock exchange, as per market quotation nearer to the date of transfer worked out to Rs.5.97 lakhs instead of Rs.4.40 lakhs declared in the balance sheet. Since the market value of house property and shares exceeded the book value at which they were transferred, the difference between the market value and the consideration received arising out of transfer constituted deemed gift attracting levy of gift-tax. But neither the assessee filed any gift-tax return nor had the department initiated any gift-tax proceedings. The omission, thus, resulted in escapement of gift of Rs.76.74 lakhs and non-levy of gift-tax of Rs.92.22 lakhs(including penalty for non-filling of return for the assessment year 1986-87).

The department has accepted the audit observation.

2. Under the Gift-tax Act, 1958, the value of transactions such as release, discharge, surrender, forfeiture or abandonment of any debt, or contract or other actionable claim or of any interest in property , if not bonafide, is deemed gift chargeable to gift-tax.

(i) During the previous year relevant to the assessment year 1982-83, a private limited

company advanced Rs.1 crore to its wholly owned subsidiary company for acquisition of a plot of land for construction of an office building for the assessee company. Audit scrutiny revealed (October 1988) that in the subsequent year relevant to the assessment year 1983-84, the assessee had written off the whole amount of the aforesaid advance stating it is non-refundable deposit and so not realisable. The relinquishment of debt of Rs.`1 crore by the assessee company in favour of its subsidiary company therefore, constituted deemed gift liable to gift tax. No gift-tax proceedings were, however, initiated by the department. The omission resulted in escapement of taxable gift by Rs.1 crore leading to non -levy of gift-tax of Rs.67.03 lakhs.

Ministry of Finance have accepted the audit observation.

(ii) The income-tax assessment records of two individuals for the assessment years 1982-83 and 1983-84 disclosed that the two partners transferred a building owned by them jointly, valued at Rs.33.56 lakhs as on the valuation date 31 March 1982, in part repayment of deposits of Rs.7.59 lakhs made by another individual, who was taken as a partner in the firm in consideration of the repayment of the deposits. Thus, the balance value of the building (Rs.25.97 lakhs) was transfer without any consideration and as such was a deemed gift by the two partners to the third partner to the extent of the shares surrendered by them in favour of the third partner in the new partnership, with effect from 1 April 1982. The omission to tax the deemed gift of Rs.11.69 lakhs in the hands of the two partners for the assessment year 1983-84 resulted in short levy of tax of Rs.2.86 lakhs.

The department has accepted the audit observation.

3. Under the Gift-tax Act, 1958, the value of transactions such as release, discharge, surrender, forfeiture or abandonment of any debt, contract or other actionable claim or

of any interest in property if not bonafide is deemed gift. The Central Board of Direct Taxes issued instructions in March 1976 and May 1977 clarifying that when a partnership firm is reconstituted either with the same old partners or on admission of new partners or on conversion of a sole proprietorship into a partnership and the profit sharing ratios of the partners are revised, any interest surrendered or relinquished by one or more such partners without adequate consideration in money or money's worth in favour of other partner(s) would attract levy of gift-tax. It has been judicially held[2] (April 1987) that goodwill is a property and in the event of admission of any member in the business on its conversion or as partner on its reconstitution the right to the money value of the goodwill stands transferred, and the transaction constitutes a gift under the Gift-tax Act.

(i) Two partnership firms were reconstituted during the previous year relevant to the assessment year 1986-87. Audit scrutiny (May 1989) of the records of the firms revealed that in the case of one firm, two partners representing Hindu undivided families of the specified category had foregone their share of profits in the firm to the extent of fifteen percent and ten percent in favour of an incoming partner and an existing partner while in the case of another firm the share of profit of one of the partners, an individual, to the extent of ten per cent was foregone in favour of another existing partner. The value of the future profits or goodwill thus foregone by these partners in favour of the incoming/existing partners constituted deemed gift under the Act in the hands of the partners who have relinquished their share.

However, no action was taken by the department to levy gift-tax on these partners. Taking into consideration three years purchase value of the net average profits during last five assessment years viz

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2. Commissioner of Gift-tax Vs. Chhota Lal Mohan Lal (166-ITR-124 [S.C.])

1981-82 to 1985-86, the share of goodwill foregone by the two partners in the case of the first firm worked out to Rs.9 lakhs and Rs.6 lakhs, while the share of goodwill foregone by the partner in the case of the second firm worked out to Rs.3.20 lakhs. Omission to treat these amounts as deemed gift resulted in an aggregate non-levy of gift-tax amounting to Rs.4.22 lakhs (approximately).

The department stated that necessary gift-tax assessment in the case of all the three partners have been completed in October 1990 assessing deemed gifts at Rs.10.95 lakhs, Rs.7.29 lakhs and Rs.3.19 lakhs and raising an aggregate gift-tax demand of Rs.5.33 lakhs.

(ii) A partnership firm with nine partners in the previous year relevant to the assessment year 1987-88 was dissolved in May 1987 and reconstituted with five partners. The retiring partners had 12 per cent, 16 per cent, 10 per cent and 12 per cent share of interest in the firm before its reconstitution.The retiring partners surrendered their share of interest in favour of five remaining partners without adequate consideration. There was no provision in the partnership deed prohibiting partners share in the goodwill of the firm. The firm had been earning profits and the action of the retiring assessees foregoing their share in the goodwill of the firm without adequate consideration constituted a deemed gift. However, neither the assessees filed any return of gift-tax nor was any action initiated by the department to levy gift-tax. Taking into account two years purchase value of the net profits for the previous year relevant to assessment year 1987-88 the goodwill of the firm worked out to Rs.12.30 lakhs and the share of four assessees therein amounted to Rs.5.35 lakhs. The omission to treat the amount as deemed gift resulted in non-levy of gift-tax of Rs.1.17 lakhs.

The department has raised an additional demand of Rs.1.60 lakhs.

(iii) The income-tax assessment records of a partnership firm disclosed that the same was re-constituted during the previous year relevant to the assessment year 1987-88 on retirement of one of the three partners. Audit scrutiny revealed that an outgoing partner was to be paid his share capital standing as on 31 March 1986 in the firm's accounts and an amount of Rs.6 lakhs towards goodwill. This payment of goodwill was agreed upon between the continuing partners of the firm towards compensation and goodwill so that the out-going partner shall have no right or title over the property of the re-constituted partnership firm.The value of interest thus foregone constituted interest surrendered in favour of the outgoing partner attracting deemed gift provisions in the hands of the continuing partners. However, no action was taken by the department to levy gift-tax. Taking into account the two years purchase price of the average of three years net profit, the share of good-will of the outgoing partner worked out to Rs.1.29 lakhs whereas he was paid Rs.6 lakhs towards goodwill. The difference of Rs.4.71 lakhs paid to the out going partner towards compensation in lieu of the surrender of right, title and interest over the property of the re-constituted firm, constituted deemed gift in the hands of the continuing partners attracting levy of gift-tax. But neither the assessee had filed any gift-tax return in respect of this deemed gift nor had the department called for the same.The gift of Rs.4.71 lakhs, thus escaped assessment resulting in non-levy of gift-tax of Rs.1.35 lakhs.

4. Under the provisions of Gift-tax Act, 1958, where an individual converts his individual property into Hindu undivided family (HUF) the individual shall be deemed to have made a gift of so much of the converted property as the members of the Hindu undivided family, other than the individual would be entitled if a partition of the converted property had taken place immediately after such conversion.

In the case of an individual, income from a

property was being shown in the status of an 'Individual' from assessment year 1970-71 to assessment year 1983-84 for the purposes of income-tax and wealth-tax. In March 1983, the individual converted these properties as belonging to a Hindu undivided family consisting of his wife and daughter by a settlement deed dated 22 March 1984 and alienated two-thirds of his right in the property in favour of his wife and daughter. A scrutiny of the income-tax and wealth-tax returns of the assessee for the assessment years 1967-68 and 1969-70 revealed that one house property valuing Rs.40,000 and a plot valued Rs.37,000 were purchased in December 1963 and October 1968 respectively in two cities. The assessee constructed the building on the plot during 31 March 1970 to 31 March 1972 at the cost of Rs.1.60 lakhs. The source of investment, *inter-alia*, included house building advance of Rs.50,000 and Rs.40,000 gifted to him by his father and no nucleus of investment of joint family funds in these properties was traceable in the records. Since both these properties were constructed out of individual income, throwing the same to common hotch potch attracted levy of gift-tax under the provisions of deemed gift of Gift-tax Act. The value of these properties on the date of their conversion **i.e.** 1 April 1983 on a very conservative estimate, therefore, works out to Rs.12.15 lakhs. By assuming the value of converted properties Rs.12.15 lakhs the value of deemed gift comes to Rs.8.05 lakhs, involving tax effect of Rs.1.98 lakhs.

The department has not accepted the objection in principle but stated that as a precautionary measure demand of Rs.63,958 has been created (March 1991).

Incorrect valuation of gifts of immovable properties

5.16 Under the Gift-tax Act, 1958, the value of property shall be estimated to be price which in the opinion of the assessing officer it would fetch if sold in the open market on the date of gift.

An individual gifted a dwelling house property in March 1981, (relevant to assessment year 1981-82) to her daughters-in-

law. The department, while completing the gift-tax assessment in December 1981, adopted the value of the gifted house property at Rs.1.47 lakhs. In the wealth-tax assessment of the assessee for the assessment year 1981-82 the value of the aforesaid property was adopted at Rs.3.89 lakhs on the basis of report of the Departmental Valuation Cell. However, for the purpose of gift-tax assessment adequacy of the consideration of the gifted property had to be judged, with reference to the market value of the property. The omission to adopt the value of Rs.3.89 lakhs resulted in underassessment of gift of Rs.2.42 lakhs and short levy of gift-tax of Rs.58,887.

Ministry of Finance have accepted the audit observation.

C-ESTATE DUTY

The levy of estate duty was discontinued by the Estate Duty (Amendment) Act, 1985, in respect of estate passing on death occuring on or after 16 March 1985.

5.17 Receipts from the estate duty during the financial years 1986-87 to 1990-91 vis-a-vis the Budget estimates were as under:

Year	Budget estimates (In crores of rupees)	Actuals	Variation	Percentage
1986-87	15.00	13.39	(-)1.61	(-)10.73
1987-88	10.00	8.02	(-)1.98	(-)19.80
1988-89	3.25	6.04	2.79	85.84
1989-90	3.10	4.27	1.17	34.34
1990-91*	3.50	3.07	(-)0.43	(-)12.28

*** Provisional**

5.18 The particulars of the pending assessments finalised, the assessments pending and estate duty demands in arrears in respect of the years 1986-87 to 1990-91 are as given below:

Year	No. of assessments completed during the year	No. of assessments pending at the end of the year	Arrears of demand pending collection (In crores of rupees)
1986-87	14,663	9,251	33.95
1987-88	11,704	3,095	399.73
1988-89	4,227	1,744	73.27
1989-90	2,188	1,269	24.18
1990-91*	844	1,164	33.22

* Provisional

5.19 During the test audit of assessments made under the Estate Duty Act, 1953, conducted during the period from 1 April 1990 to 31 March 1991, short levy of estate duty of Rs.0.60 crore was noticed in 110 cases. The following types of mistakes resulting in under assessment of duty, were noticed.

(i) Incorrect computation of principal value of estate-Undervaluation of the principal value of estate.

(ii) Estate not assessed.

(iii) Incorrect valuation of assets

(a) Immovable properties

(b) Unquoted equity shares

(iv) Incorrect grant of relief/deduction

(v) Non-levy of interest/ penalty.

A total number of 25 draft paragraphs involving tax effect of Rs.49.74 lakhs were issued to the Ministry of Finance for comments during January 1991 to July 1991. 10 cases (involving tax effect of Rs.32.75 lakhs) are given in the following paragraphs. The Ministry of Finance have accepted the observation in 4 cases.

Incorrect computation/ under valuation of principal value of estate

5.20. Under the Estate Duty Act, 1953, before its discontinuance by the Estate Duty (Amendment) Act, 1985, the value of estate is estimated to be the price which it would fetch if sold in the open market at the time of deceased's death.

(i) In the estate duty assessment (completed in September 1984) of a deceased, who died on 27 April 1983, the value of estate consisting of a plot of 1022 sq. yards being one half share of a free hold plot, was adopted by the valuer at the rate of Rs.150 per sq. yard as against Rs.2,000 per sq. metre (Rs.1,672.25 per sq. yard) fixed by Ministry of Works and Housing (Land division) vide their circular letter of October 1981. The non-adoption of the market value resulted in under valuation of estate by Rs.9.52 lakhs, and short levy of duty of Rs.2.49 lakhs.

(ii) The principal value of estate of a deceased consisted of some house properties, besides other immovable and movable estate. It was noticed that the deceased was co-owner of a house property having one-half share in it. The Departmental Valuer had estimated the value of the said house property at Rs.10.54 lakhs and value of one-half share of the deceased was estimated at Rs.5.27 lakhs. While framing the assessment order in May 1989, the assessing officer adopted the value of the said house property at Rs.2.64 lakhs instead of Rs.5.27 lakhs. The omission resulted in short computation in principal value of estate by Rs.2.63 lakhs and consequent short levy of estate duty of Rs.1 lakh (inclusive of interest of Rs.16,697 leviable for late filing of return).

The department has accepted the audit observation.

Estate not assessed

5.21.1 Under the provisions of the Estate Duty Act, 1953, the properties gifted within two years before the date of death of the deceased are deemed to pass on death and are includible in the dutiable estate of the deceased.

In the estate-duty assessment completed in March 1987 in respect of the estate of a person who died in January 1982, the assessing officer did not include the value of National Defence Gold Bonds, 1980 for 5857 grams of gold gifted by the deceased in July 1980 which was within the statutory period of two years before his death, on the plea

thatthe said Bonds were exempt under the Act ibid. Scrutiny of assessment records in November 1987 revealed that the value of Gold Bonds were determined at Rs.7.32 lakhs in the gift-tax assessment and exemption under the Gift-tax Act, 1958, was disallowed as the assessee was not the first subscriber of the Bonds. Under the Estate Duty Act, ibid, the value of Gold Bonds repayable in gold by Government in October 1980 would pass on death and as such was includible in the estate. As the gift was made within two years before death, omission to include the value of Gold Bonds gifted resulted in escapement of estate by Rs.7.32 lakhs with consequent short lavy of duty of Rs.6.22 lakhs

2. Share interest of a partner in a firm representing his capital in that firm and his share of surplus arising out of revaluation of the assets of the firm pass on death.

In the assessment of principal value of the estate of a person who died on 31 December 1982, completed in November 1987 and revised in March 1988, deposit of Rs.53,496 in Saving Bank Account, special term deposit of Rs.24,210 receivable by the deceased, on maturity in February 1985, life insurance policy for a sum assured of Rs.25,000 and accrued interest of Rs.4,935 were not included in the principal value of the estate of the deceased though the information was furnished by the person in October 1984, in response to a notice issued under the Act, for the realisation of outstanding demand of estate duty payable by the accountable person. Thus the principal value of Rs.1.08 lakhs escaped assessment resulting in short levy of duty of Rs.38,738. Penalty not exceeding Rs.77,476 for concealment of the particulars of the estate, at twice the amount of duty was also leviable.

The department has accepted the audit observation.

Incorrect valuation of assets

5.22 (a) Immovable properties

Under the provisions of the Estate Duty Act, 1953, the value of property included in the

principal value of an estate is estimated to be the price which it would fetch if sold in the open market at the time of death of the deceased. According to the instructions issued by the Central Board of Direct Taxes in August 1974, the assessing officer should ordinarily take the value of an immovable property in the estate duty assessment in conformity with the value estimated by the Departmental Valuation Officer. In case the assessing officer disagrees with the value estimated by the Departmental Valuer, he may take up the matter with the Controller of Estate Duty who may issue necessary instructions in consultation with the Regional Valuation Officer.

An accountable person furnished in June 1979 the return in respect of person who died in August 1976. He had shown therein the value of a cinema house at Rs.1.80 lakhs. On a reference by the Assessing Officer in September 1985, the Departmental Valuer valued (October 1987) the property at Rs.14.93 lakhs (Land at Rs.10.25 lakhs and building at Rs.4.68 lakhs) as on the date of death.

Nine years after the return was furnished by the accountable person, the assessing officer determined (March 1988) the net principal value of the estate at Rs.12.54 lakhs including Rs.11.08 lakhs in respect of the cinema house (land at Rs.6.40 lakhs and building at Rs.4.68 lakhs), which was lower than the value as determined by the Departmental Valuer. He had not taken up the matter with the Controller of Estate Duty in accordance with the instructions before adopting the lower value. This resulted in under assessment of estate by Rs.3.85 lakhs with consequent short levy of duty of Rs.1.68 lakhs. The market value of the plant and machinery was also not included in the assessment. Further, liability of Rs.3.28 lakhs was allowed as deduction without supporting evidence.

Ministry of Finance have accepted the audit observation.

(b) Unquoted equity shares

Under the provisions of the Estate Duty Act, 1953, and instructions issued by the Central Board of Direct Taxes in October 1974 and May 1975, unquoted equity shares in a private limited company held by the deceased should be valued for the purpose of levy of estate duty on the basis of the market value of the assets of the company, including goodwill as on the date of death of the deceased person.

The estate of a person (died in June 1964) comprised, inter alia, 2087 unquoted equity shares in a private limited company which restricted alienation of its shares. In the estate duty assessment completed in July 1986, the shares were valued by the assessing officer at Rs.228.40 per share under break-up value method. It was observed in audit that the assessing officer while determining the value of the unquoted equity shares omitted to disallow a sum of Rs.5.61 lakhs being fictitious loan liability to arrive at the net wealth of the company. After disallowing the aforesaid liability the value of each share would work out to Rs.340.65 as against Rs.228.40 adopted in the estate duty assessment. This resulted in undervaluation of the shares by Rs.2.34 lakhs. The estate of the deceased was thus underassessed by like amount leading to short levy of duty by Rs.1.02 lakhs.

The department has accepted the audit observation.

Incorrect grant of relief/ deduction

5.23 Under the Estate duty Act, 1953, in the case of every person dying after the commencement of the Act, estate duty was to be levied upon the principal value of the estate, ascertained in the manner laid down in the Act, which passes on the death of such person. The Central Board of Direct Taxes issued instructions in November 1973 and April 1979 emphasising the need for correlation of assessments made under various direct taxes with a view to bring to tax cases of evasion of tax.

In the estate duty assessment made during

January 1989 in respect of a person who died in November 1984, the following mistakes were noticed:

(i) Value of equity shares of a limited company was `nil' whereas the same was taken as Rs.12,000 in the wealth-tax assessment of the deceased for assessment year 1984-85. A sum of Rs.12,000 was as such to be added to the principal value of the estate.

(ii) Under the provisions of Estate Duty Act, 1953, gifts made within two years before the death of the deceased were liable to estate duty.

As per the gift-tax assessment of the deceased for assessment year 1984-85 completed in October 1984, the deceased gave a gift of Rs.1 lakh on 20 June 1983 to his minor grand daughter. The amount of gift was as such to be added to the principal value of the estate.

(iii) Under the Act **ibid** deduction of debts (with some exceptions) were to be allowed for determining chargeable value of the estate.

Taxation liability claimed in respect of `Individual' estate included liability on account of penalty and taxation amounting to Rs.1.48 lakhs in respect of gift-tax, for assessment year 1969-70. The same was, however, reduced to `Nil' as per Commissioner of Income-tax (Appeal)'s orders dated 12 August 1988. Similarly, a liability of Rs.66,300 was claimed in income-tax assessment, for assessment year 1969-70. But no such liability existed, instead a refund of Rs.9,279 was made in May 1988. The sum of Rs.2.24 lakhs (Rs.1,48,429 plus Rs.66,300 plus Rs.9,279) was as such required to be added back to the principal value of the estate.

(iv) The Act **ibid**, **inter alia**, provides exemption of moneys payable under the life insurance policies effected by the deceased on his own life.

The exemption admissible was not from aggregation for the determination of effective rate of duty but a rebate in duty only was admissible. The deduction of Rs.5,000 claimed from the principal value of the estate was as such to be added back.

The above omissions/mistakes resulted in underassessment of principal value of estate of Rs.3.40 lakhs and short levy of estate duty of Rs.2.86 lakhs.

Ministry of Finance have accepted the audit observation.

Non/short levy of penalty and interest

5.24.1. Penalty

Under the Estate Duty Act, 1953, where the accountable person has without reasonable cause failed to deliver the accounts of the estate of the deceased within the time allowed under the Act, he is liable to pay by way of penalty, in addition to the amount of the estate duty payable by him, a sum not exceeding twice the amount of such duty.

In ten cases the accountable persons did not deliver accounts of the properties of the deceased persons in respect of which estate duty was payable, within six months of the death. Estate duty assessments were completed in these cases in 1987-88 (nine cases) and 1989-90 (one case) but proceedings for the levy of penalty were not initiated by the Assessing Officers. Maximum penalty of Rs.15 lakhs (equal to twice the amount of estate duty levied in ten cases) was leviable which was not levied by the department.

2. Interest

Under the provisions of the Estate duty Act, 1953, if return of the estate of the deceased person is not furnished by the accountable person within six months of the date of death of the deceased person, interest at six percent per annum on the estate duty is leviable.

(i) While completing the assessment in March 1988 in the case of a person who died in 1983

and for whom the accountable person did not furnish the return, the assessing officer failed to levy interest for the non-submission of the return within the stipulated period. Further, while determining the principal value of estate, the value of agricultural land situated at various places was short computed by Rs.80,000 and capitalised value of house property at Rs.8,800 was not included in the principal value of estate. Besides rebate on agricultural land was irregularly allowed from estate duty by Rs.9,581.

The above omissions resulted in short levy of estate duty of Rs.76,206 (including interest of Rs.41,985 for non-submission of return within the prescribed time).

Ministry of Finance have accepted the audit observation.

(ii) An accountable person furnished the return due in June 1983, in respect of a person who died in December 1982, only in February 1984. While completing the assessment in January 1988, the assessing officer did not levy interest for the delay in submission of return. The omission resulted in short levy of interest of Rs.55,656.

Ministry of Finance have accepted the audit observation.

D-HOTEL RECEIPTS TAX

5.25 Mistake in computation of chargeable receipts

Under the provisions of the Hotel Receipts Tax Act, 1980 all charges received by, accruing or arising to the assessee in connection with the provisions of any residential accommodation, food, drink and other services in the course of carrying on the business of a hotel as defined in the Act, shall be `chargeable receipts' subject to certain deductions specified therein such as bad debts, hotel receipts tax and sales tax, entertainment tax or tax on luxuries

relatable to hotel receipts and are taxable at the flat rate of 15 percent of such receipts.

The Hotel receipts tax assessments of a company for the assessment years 1982-83 and 1983-84 were completed by the Deputy Commissioner of Income-tax in January 1990 on chargeable receipts of Rs.187.34 lakhs and Rs.339.09 lakhs respectively. Audit scrutiny (July 1990) revealed that in computing the chargeable receipts, the assessee was allowed a deduction of Rs. one lakh each for both the assessment years towards provision for bad debts, Rs.2.80 lakhs and Rs.4.70 lakhs towards commission paid to travel agents and guests and Rs.5.29 lakhs and Rs.7.60 lakhs towards payments made to the Posts and Telegraphs department for telephone/telex services for the assessment years 1982-83 and 1983-84 respectively. As these deductions were not allowable under the Act and were required to be disallowed, the incorrect allowance of these deductions resulted in short computation of chargeable receipts by Rs.9.09 lakhs and Rs.13.30 lakhs for the assessment years 1982-83 and 1983-84 respectively involving an aggregate short levy of tax of Rs.2.92 lakhs.

New Delhi **(P.K. LAHIRI)**
The 9 APR 1992 **Principal Director of Receipt Audit (Direct Taxes)**

Countersigned

New Delhi **(C.G. SOMIAH)**
The 9 APR 1992 **Comptroller and Auditor General of India**

ERRATA A.R. 1990-91

Page	Para	Column	Line	For	Read
xxiv	(vii)	--	Ist	including interest	Deleted
xxvi	5	4 from bottom	-	Rs.175.85	195.85
xxvii	f (iv)	--	4 from bottom	As per terms of agreements	deleted.
9	(ii)	6	Table against(g)	0.01	0.03
10	1.04.1	--	Above table	---	(In crores of rupees)
10	1.04.1	2	Table against 1989-90	10,004.78	10,007.78
24	(e)	--	6 from bottom	(Rupees in crores of rupees)	(in crores of rupees)
35	(f)	2	Table Ist from bottom	469	460
36	(f)	4	Table Ist from top	7,876	9,876
38	1.11	--	3	state	stage
43	(iii)(b)	2	Table against 1989-90	2,813	2,481
44	(d)	4	Table against 1990-91	1877@	18,770
44	(d)	7	--do--	1595@	15,954
44	(e)	--	Ist line	cases returned,	cases of assets returned,
48	1.16	--	Table Sr.No.(iv)	No.of value of properties	No.of properties
49	1.18	6	Table Sr.No.1(a)	13.56	1,356
49	1.18	6	Table againsy iv(c)	7,154	7,152
49	1.18	5	Last line Table	288.03	282.03
95	2.01.16	--	11 from bottom	Statement 'X'	deleted

95	2.01.16	--	2 from bottom	1990-91	1990-91* *Provisional
165	U.P.charge	--	19 from top	114.18	114.19
165	--do--	--	25 from top	16.87	12.53
187	3.07(iii) Item No.4	4	-	5.9	5.91
188	3.07(iv) Item No.1	4	-	101.9	101.99
188	3.07(iv) Item No.1	-	7 from top	Loss of	deleted
	Item No.2	4	-	30.3	30.38
	Item No.3	4	-	20.7	20.71
	Item No.4	4	-	17.0	17,05
	Item No.5	4	-	10.5	10.59
	ItemNo.6	4	-	7.4	7.44
199	3.14	-	18 from bottom	29 January	29 February
200	3.15	-	10 from bottom	28 March	28 February
210	323	--	Heading 3 &4 line from top	Excess in expenditure	Excess Expenditure
212	3.25	--	2 from top	of	or
224	3.27.8	--	19 from top	led to to	led to
272	3.39.3(i)	--	13 from bottom	19889	1989
279	340.4(ii)	--	(from above)	43.97	43.96
281	3.41	--	5 from top	business firm	deleted
281	3.41	--	11 from top	resulted in	involving
314	3.59	--	Sl.No.10	1987-886	1987-88
368	5.03	--	11 from bottom	t.a.x	tax
390	5.12	--	1 from bottom	1987-88	1988-89
400	5.17	--	(Table 7 from bottom	34.34	34.74